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FOR CA FINAL EXAM PREPARATION

CA Final 2022 Suggested Answers · Group I (All Papers) (Old Scheme)

EXAM	YEAR	TYPE	SUBJECT
CA Final	2022	Suggested Answers	Group I (All Papers) (Old Scheme)

DATE

November 2022

SUGGESTED ANSWERS TO QUESTIONS SET AT THE

FINAL EXAMINATION – GROUP I

NOVEMBER, 2022



BOARD OF STUDIES

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

(Set up by an Act of Parliament)

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Edition	:	June, 2023
Website	:	www.icai.org
Department/Committee	:	Board of Studies
E-mail	:	bosnoida@icai.in
ISBN No.	:	
Price	:	
Published by	:	The Publication Department on behalf of The Institute of Chartered Accountants of India, ICAI Bhawan, Post Box No. 7100, Indraprastha Marg, New Delhi- 110 002, India Typeset and designed at Board of Studies.
Printed by	:	

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PAPER – 1 : FINANCIAL REPORTING

*Question No.**1** is compulsory. Candidates are required to answer any **four** questions from the remaining **five** questions.*

Working notes should form part of the respective answers.

Question 1

(a) Given below are the balance sheets of a group of companies comprising X Ltd., Y Ltd. and Z Ltd. as on 31st March, 2022: *(₹ in Lakhs)*

	X Ltd.	Y Ltd.	Z Ltd.
Assets			
Non-current Assets			
Property, plant and equipment	1,120	1,260	1,050
Investment:			
112 lakh shares in Y Ltd.	1,190		
84 lakh shares in Z Ltd.		980	
Current assets			
Inventories	770	245	175
Financial assets:			
Trade receivables	910	350	770
Bills receivables	252	-	105
Cash in hand and at bank	798	140	140
	5,040	2,975	2,240
Equity and Liabilities			
Shareholder's equity			
Share capital (₹ 10 per share)	2,100	1,400	1,120
Other equity:			
Reserves	630	350	280
Retained earnings	560	175	210
Current liabilities			
Financial liabilities:			
Trade payables	1,645	805	630
Bills payable			
X Ltd.	-	245	-

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Y Ltd.	*105*	*-*	*-*
	5,040	*2,975*	*2,240*

The following additional information is available:

(i) X Ltd. holds 80% shares in Y Ltd. and Y Ltd. holds 75% shares in Z Ltd. Their holdings were acquired on 30th September, 2021.

(ii) The business activities of all the companies are not seasonal in nature and therefore, it can be assumed that profits are earned evenly throughout the year.

(iii) On 1st April 2021, the following balances stood in the books of Y Ltd. and Z Ltd.

(₹ in lakhs)

	Y Limited	*Z Limited*
Reserve	*280*	*210*
Retained earnings	*70*	*105*

(iv) ₹ 35 lakhs included in the inventory figure of Y Ltd. is inventory which has been purchased from Z Ltd. at cost plus 25%.

(v) The parent company has adopted an accounting policy to measure non-controlling interest at fair value (quoted market price) applying Ind AS 103. Assume that market price of the shares of Y Ltd. and Z Ltd. are the same as their respective face values.

(vi) Y Ltd. purchased goods from Z Ltd. after acquiring the shares of Z Ltd.

You are required to prepare consolidated balance sheet, as at 31st March 2022, of the group of companies X Limited, Y Limited and Z Limited. ***(15 Marks)***

(b) Silver Ltd. is in the process of acquiring shares of Blue Ltd. as a part of business reorganization plan. The projected free cash flow of Blue Ltd. for the next 5 years is as follows: *(₹ in crores)*

Particulars	*Year 1*	*Year 2*	*Year 3*	*Year 4*	*Year 5*
Cash flows	*280.65*	*281.40*	*182.70*	*403.50*	*518.20*
Terminal value					*5,945*

The weighted average cost of capital of Blue Ltd. is 10%. The total debt as on measurement date is ₹ 2,195 crore and the surplus cash and cash equivalent is ₹ 159.21 crore.

The total number of shares of Blue Ltd. as on the measurement date is 12.80 crore.

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You are required to determine the value per share of Blue Ltd. as per Income Approach of Ind AS 113.

(Present value factor of ₹ 1 should be taken upto 4 decimals for the purpose of calculation) ***(5 Marks)***

Answer

(a) Consolidated Balance Sheet of the Group as on 31st March, 2022

Particulars	*Note No.*	*₹ in lakh*
ASSETS		
Non-current assets		
(a) Property, Plant and Equipment	1	3,430.00
Current Assets		
(a) Inventories	2	1,183.00
(b) Financial assets		
(i) Trade receivables	3	2,142.00
(ii) Cash and Cash equivalents	4	1,078.00
Total assets		7,833.00
EQUITY & LIABILITIES		
Equity attributable to owners of parent		
(a) Share Capital		2,100.00
(b) Other Equity	5	1,966.30
Non-controlling interests (W.N.4)		581.70
Total equity		4,648.00
LIABILITIES		
Non-current liabilities		Nil
Current liabilities		
(a) Financial Liabilities		
(i) Trade payables	6	3,185.00
Total liabilities		3,185.00
Total Equity and Liabilities		7,833.00

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Notes to Accounts **(₹ in lakh)**

1.	**Property, Plant & Equipment**		
	X Ltd.	1,120.00	
	Y Ltd.	1,260.00	
	Z Ltd.	1,050.00	3,430.00
2.	**Inventories**		
	X Ltd.	770.00	
	Y Ltd. (245 – 7)	238.00	
	Z Ltd.	175.00	1,183.00
3.	**Trade Receivables**		
	X Ltd.	910.00	
	Y Ltd.	350.00	
	Z Ltd.	770.00	
	(A)	2,030.00	
	Bills Receivables		
	X Ltd. (252 – 245)	7.00	
	Z Ltd.	105.00	
	(B)	112.00	
	Total Trade Receivables (A+B)		2,142.00
4.	**Cash & Cash equivalents**		
	X Ltd.	798.00	
	Y Ltd.	140.00	
	Z Ltd.	140.00	1,078.00
5.	**Other Equity**		
	Reserve (W.N.5)	679.00	
	Retained Earnings (W.N.5)	629.30	
	Capital Reserve (W.N.3)	658.00	1,966.30
6.	**Trade Payables**		
	X Ltd.	1,645.00	
	Y Ltd.	805.00	
	Z Ltd.	630.00	
	(A)	3,080.00	

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	Bills payable		
	X Ltd.	105.00	
	Y Ltd. (245 - 245)	-	
	(B)	105.00	
	Total Trade Payables (A+B)		3,185.00

***Note:** Bills Payable of X Ltd. is not reflecting as Bills Receivable of Y Ltd. This may happen since Y Ltd. may have discounted/endorsed the same to the bank/third party.

Working Notes:

1. Analysis of Reserves and Surplus **(₹ in lakh)**

		Y Ltd.		Z Ltd.
Reserves as on 31.3.2021		280.00		210.00
Increase during the year 2021-2022	70.00		70.00	
Increase for the half year till 30.9.2021		35.00		35.00
Balance as on 30.9.2021 (A)		**315.00**		**245.00**
Total balance as on 31.3.2022		350.00		280.00
Post-acquisition balance of Reserves		**35.00**		**35.00**
Retained Earnings as on 31.3.2021		70.00		105.00
Increase during the year 2021-2022	105.00		105.00	
Increase for the half year till 30.9.2021		52.50		52.50
Balance as on 30.09.2021 (B)		**122.50**		**157.50**
Total balance as on 31.3.2022		175.00		210.00
Post-acquisition balance of RE		52.50		52.50
Less: Unrealised Gain on inventories [(35 ÷ 125) x 25]		-		(7.00)
Post-acquisition balance of RE for CFS		**52.50**		**45.50**
Total balance on the acquisition date ie.30.9.2021 (A+B)		**437.50**		**402.50**

2. Calculation of Effective Interest of X Ltd. in Z Ltd.

Acquisition by X Ltd. in Y Ltd. = 80%

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Non-controlling Interest of Y Ltd. = 20%

Acquisition by Y Ltd. in Z Ltd. = 75%

Acquisition by Group in Z Ltd. (80% x 75) = 60%

Non-controlling Interest of Z Ltd = 40%

3. Calculation of Goodwill / Capital Reserve on acquisition of subsidiaries

₹ in lakhs

	Y Ltd.	Z Ltd.
Investment or consideration	1,190.00	(980 x 80%) 784.00
Add: NCI at Fair value		
(1,400 x 20%)	280.00	
(1,120 x 40%)	-	448.00
	1,470.00	1,232.00
Less: Identifiable net assets (Share Capital + Increase in the Reserves and Surplus till acquisition date)	(1,400+437.50) (1,837.50)	(1,120+402.50) (1,522.50)
Capital Reserve	367.50	290.50
Total Capital Reserve (367.50 + 290.50)	658.00	

4. Calculation of Non-controlling Interest **₹ in lakhs**

	Y Ltd.	Z Ltd.
At Fair Value (See Note 3)	280.00	448.00
Add: Post Acquisition Reserves (See Note 1)	(35 x 20%) 7.00	(35 x 40%) 14.00
Add: Post-acquisition retained earnings (See Note 1)	(52.50 x 20%) 10.50	(45.50 x 40%) 18.20
Less: NCI share of investment in Z Ltd.	(980 x 20%) (196.00)*	-
	101.50	480.20
Total (101.50 + 480.20)	581.70	

*Note: The non-controlling interest in Y Ltd. will take its proportion in Z Ltd. So, they have to bear their proportion in the investment by Y Ltd. (in Z Ltd.) also.

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5. Calculation of Consolidated Other Equity **₹ in lakhs**

	Reserves	Retained Earnings
X Ltd.	630.00	560.00
Add: Share in Y Ltd.	(35 x 80%) 28.00	(52.50 x 80%) 42.00
Add: Share in Z Ltd.	(35 x 60%) 21.00	(45.50 x 60%) 27.30
	679.00	629.30

In the above solution, it is assumed that profits of Z Ltd. has been earned evenly throughout the year irrespective of post-acquisition sale of goods to Y Ltd.

Alternatively, profit on sale of goods to Y Ltd. is deducted from total profit of Z Ltd. before distribution of total profit of Z Ltd. into pre-acquisition and post-acquisition. In such a case, the solution will be as follows:

Consolidated Balance Sheet of the Group as on 31st March, 2022

Particulars	Note No.	₹ in lakh
ASSETS		
Non-current assets		
(a) Property, plant and equipment	1	3,430.00
Current assets		
(c) Inventory	2	1,183.00
(d) Financial assets		
(i) Trade receivable	3	2,142.00
(ii) Cash and cash equivalents	4	1,078.00
Total assets		7,833.00
EQUITY & LIABILITIES		
Equity attributable to owners of parent		
Share Capital		2,100.00
Other Equity	5	1,964.90
Non-controlling interests (W.N.4)		583.10
Total equity		4,648.00

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LIABILITIES		
Non-current liabilities		Nil
Current liabilities		
(b) Financial Liabilities		
(i) Trade payables	6	3,185.00
Total liabilities		3,185.00
Total equity and liabilities		7,833.00

Notes to Accounts **(₹ in lakh)**

1.	**Property, plant & equipment**		
	X Ltd.	1,120.00	
	Y Ltd.	1,260.00	
	Z Ltd.	1,050.00	3,430.00
2.	**Inventories**		
	X Ltd.	770.00	
	Y Ltd. (245 – 7)	238.00	
	Z Ltd.	175.00	1,183.00
3.	**Trade receivable**		
	X Ltd.	910.00	
	Y Ltd.	350.00	
	Z Ltd.	770.00	
	(A)	2,030.00	
	Bills receivable		
	X Ltd. (252 – 245)	7.00	
	Z Ltd.	105.00	
	(B)	112.00	
	Total Trade Receivables (A+B)		2,142.00
4.	**Cash & cash equivalents**		
	X Ltd.	798.00	
	Y Ltd.	140.00	
	Z Ltd.	140.00	1,078.00

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5.	**Other equity**		
	Reserve (W.N.5)	679.00	
	Retained Earnings (W.N.5)	631.40	
	Capital Reserve (W.N.3)	654.50	1,964.90
6.	**Trade payable**		
	X Ltd.	1,645.00	
	Y Ltd.	805.00	
	Z Ltd.	630.00	
	(A)	3,080.00	
	Bills payable		
	X Ltd.	105.00	
	Y Ltd. (245 - 245)	-	
	(B)	105.00	
	Total of Trade payable (A+B)		3,185.00

*Note: Bills Payable of X Ltd. is not reflecting as Bills Receivable of Y Ltd. This may happen since Y Ltd. may have discounted / endorsed the same to the bank/third party.

Working Notes:

1. Analysis of Reserves and Surplus **(₹ in lakh)**

		Y Ltd.		Z Ltd.
Reserves as on 31.3.2021		280.00		210.00
Increase during the year 2021-2022	70.00		70.00	
Increase for the half year till 30.9.2021		35.00		35.00
Balance as on 30.9.2021 (A)		315.00		245.00
Total balance as on 31.3.2022		350.00		280
Post-acquisition balance of Reserves		**35.00**		**35.00**
Retained Earnings as on 31.3.2021		70.00		105.00
Increase during the year 2021-2022 for Y Ltd.	105.00			
Increase during the year 2021-22 for Z Ltd. 105.00				
Less: Unrealised gain [(35/125)x25] (7.00)				
Profit of the year earned evenly for Z Ltd. 98.00			98	

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Increase for the half year till 30.9.2021		52.50		49.00
Balance as on 30.9.2021	(B)	**122.50**		**154.00**
Total balance as on 31.3.2022		(175.00)		(210.00)
Post-acquisition balance		52.50		56.00
Less: Unrealised gain on inventories [(35/125)x25]		-		(7.00)
Post-acquisition balance for CFS		52.50		49.00
Total balance on the acquisition date ie. 30.9.2021 (A+B)		437.50		399.00

2. Calculation of Effective Interest of X Ltd. in Z Ltd.

Acquisition by X Ltd. in Y Ltd.	= 80%
Non-controlling Interest of Y Ltd.	= 20%
Acquisition by Y Ltd. in Z Ltd.	= 75%
Acquisition by Group in Z Ltd. (80% x 75%)	= 60%
Non-controlling Interest of Z Ltd	= 40%

3. Calculation of Goodwill / Capital Reserve on the acquisition (₹ in lakhs)

	Y Ltd.	Z Ltd.
Investment or consideration	1,190	(980 x 80%) 784
Add: NCI at Fair value		
(1,400 x 20%)	280	
(1,120 x 40%)	-	448
	1,470	1,232
Less: Identifiable net assets (Share Capital + Increase in the Reserves and Surplus till acquisition date)	(1,400+437.50) (1,837.50)	(1,120+399) (1,519.00)
Capital Reserve	367.50	287.00
Total Capital Reserve (367.50 + 287.00)	654.50	

4. Calculation of Non-controlling Interest (₹ in lakhs)

	Y Ltd.	Z Ltd.
At Fair Value (See Note 3)	280.00	448.00

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Add: Post-acquisition Reserves (See Note 1)	(35 x 20%) 7.00	(35 x 40%) 14.00
Add: Post-acquisition Retained Earnings (See Note 1)	(52.50 x 20%) 10.50	(49.00 x 40%) 19.60
Less: NCI share of investment in Z Ltd.	(980 x 20%) (196.00)*	-
	101.50	481.60
Total (101.50 + 481.60)	583.10	

*Note: The non-controlling interest in Y Ltd. will take its proportion in Z Ltd. So, they have to bear their proportion in the investment by Y Ltd. (in Z Ltd.) also.

5. Calculation of Consolidated Other Equity **(₹ in lakhs)**

	Reserves	Retained Earnings
X Ltd.	630.00	560.00
Add: Share in Y Ltd.	(35 x 80%) 28.00	(52.50 x 80%) 42.00
Add: Share in Z Ltd.	(35 x 60%) 21.00	(49.00 x 60%) 29.40
	679.00	631.40

(b) Determination of Equity Value of Blue Ltd. **(₹ in crore)**

Particulars	Year 1	Year 2	Year 3	Year 4	Year 5
Cash flows	280.65	281.40	182.70	403.50	518.20
Terminal value					5,945
	280.65	281.40	182.70	403.50	6,463.20
Discount rate @ 10%	0.9091	0.8264	0.7513	0.6830	0.6209
Free cashflow available to the firm	255.14	232.55	137.26	275.59	4,013.00
Total of all years					4,913.54
Less: Debt					(2,195.00)
Add: Cash & cash equivalent					159.21
Equity value of PT Ltd.					2,877.75
No. of shares (in crore)					12.80 Cr.
Per share value (₹ 2,877.75 Cr. / 12.80 Cr)					₹ 224.82

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Question 2

(a) *On 1st April, 2021, Mohan Ltd. has sold goods to Hari Ltd. at a consideration of ₹ 7,50,000. The receipt of this is receivable in three equal instalments of ₹ 2,50,000 each over a two-year period (receipts on 1st April, 2021; 31st March 2022 and 31st March 2023).*

The company is offering a discount of 5% (i.e. ₹ 37,500), if payment is made in full at the time of sale. The sale agreement reflects an implicit interest rate of 5.358% p.a.

The total consideration to be received from such sale is at ₹ 7,50,000 and hence, the management has recognized the revenue from sale of goods for ₹ 7,50,000.

You are required to analyse whether the above accounting treatment made by the accountant is in compliance of Ind AS. If not, advise the correct treatment alongwith journal entries and extracts of Statement of Profit & Loss and Balance Sheet. ***(6 Marks)***

(b) *A Ltd. is in the business of infrastructure and has two divisions. The brief details of its business and underlying project details are as follows:*

Project 1: Ludhiana - Chandigarh Expressway Toll Project

The Company has commenced the construction of the project in the current year. The brief details of the Concession Agreement are given below:

- *Total expenses incurred ₹ 100 crore as on 31st March, 2022.*
- *Under IGAAP, the company has recorded such expenses as intangible assets in the books of account. Total expenses estimated to be incurred on the project are ₹ 200 crore;*
- *Fair value of the construction service is ₹ 220 crore;*
- *Total cash flow guaranteed by the government under the concession agreement is ₹ 350 crore;*
- *Finance revenue over the period of operation phase is ₹ 30 crore;*
- *Other income relates to the services provided during the operation phase.*

Project 2: Bengaluru - Chennai Expressway Toll Project

The Company has also entered into another Concession Agreement with Government of Karnataka in the current year. The said concession agreement is Toll Based Project and the Company needs to collect the toll from the users of the expressway. The construction cost for the said project will be ₹ 150 crore. The fair value of such construction cost is approximately ₹ 200 crore. Under IGAAP, the company has recorded the expenses incurred on the said project as an intangible asset.

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You are required to answer the following:

(i) What would be the classification of Ludhiana - Chandigarh Expressway Toll Project as per applicable Ind AS? Give brief reasoning.

(ii) What would be the classification of Bengaluru – Chennai Expressway Toll Project as per applicable Ind AS? Give brief reasoning.

(iii) What should be the accounting entries for the preparation of financial statements as per relevant Ind AS for the above 2 projects? ***(10 Marks)***

(c) An entity enters into a contract for the sale of Product A for ₹ 10,000. As part of the contract, the entity gives the customer a 40% discount voucher for any future purchases upto ₹ 8,000 in the next 30 days. The entity intends to offer a 10% discount on all sales during the next 30 days as a part of seasonal promotion. The 10% discount cannot be used in addition to the 40% discount voucher.

The entity believes that there is 75% likelihood that a customer will redeem the voucher and, on an average, a customer will purchase ₹ 5,000 of additional products.

You are required to determine how many performance obligations does the entity have with their stand-alone selling price and allocated transaction price? ***(4 Marks)***

Answer

(a) The revenue from sale of goods shall be recognised at the fair value of the consideration received or receivable. The fair value of the consideration is determined by discounting all future receipts using an imputed rate of interest where the receipt is deferred beyond normal credit terms. The difference between the fair value and the nominal amount of the consideration is recognised as interest revenue. Hence, the accounting treatment of recognizing revenue of ₹ 7,50,000 by the accountant is not correct.

The fair value of consideration (cash price equivalent) of the sale of goods to be recognised on the date of sale should be calculated as follows:

Period	Consideration (Installment)	Present value factor	Present value of consideration
	₹		₹
Time of sale	2,50,000	-	2,50,000
End of 1st year	2,50,000	0.949	2,37,250
End of 2nd year	2,50,000	0.901	2,25,250
	7,50,000		7,12,500

Mohan Ltd. will recognise the revenue from sale of goods and finance income as follows:

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Particulars		₹	₹
Initial recognition of sale of goods			
Cash / Bank A/c	Dr.	2,50,000	
Trade Receivable A/c	Dr.	4,62,500	
To Sale A/c			7,12,500
Recognition of interest expense and receipt of second installment			
Cash / Bank A/c	Dr.	2,50,000	
To Interest Income A/c (4,62,500 x 5.358%)			24,781
To Trade Receivable A/c			2,25,219
Recognition of interest expense and payment of final installment			
Cash / Bank A/c	Dr.	2,50,000	
To Interest Income A/c (Balancing figure)			12,719
To Trade Receivable A/c (4,62,500 – 2,25,319)			2,37,281

Statement of Profit and Loss (Extracts)

for the year ended 31st March, 2022 and 31st March, 2023

	As at 31st March, 2022	As at 31st March, 2023
	₹	₹
Income		
Sale of Goods	7,12,500	-
Other Income (Finance income)	24,781	12,719

Balance Sheet (extracts) as at 31st March, 2022 and 31st March, 2023

	As at 31st March, 2022	As at 31st March, 2023
	₹	₹
Assets		
Current Assets		
Financial Assets		
Trade Receivables	2,37,281	XXX

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(b) (i) Project 1 : Ludhiana - Chandigarh Expressway Toll Project

Here the operator has a contractual right to receive cash from the grantor. The grantor has little, if any, discretion to avoid payment, usually because the agreement is enforceable by law. The operator has an unconditional right to receive cash if the grantor contractually guarantees to pay the operator. Hence, the operator recognizes a financial asset to the extent it has a contractual right to receive cash.

(ii) Project 2 : Bengaluru - Chennai Expressway Toll Project

Here the operator has a contractual right to charge users of the public services. A right to charge users of the public service is not an unconditional right to receive cash because the amounts are contingent on the extent that the public uses the service. Therefore, the operator shall recognise an intangible asset to the extent it receives a right (a license) to charge users of the public service.

(iii) Accounting Entries for preparation of financial statements

Ludhiana-Chandigarh Expressway Toll Project

Journal Entries

	Particulars	Dr. (₹ in crore)	Cr. (₹ in crore)
	During construction:		
1	Financial asset A/c Dr.	220	
	To Construction revenue		220
	(To recognise revenue relating to construction services, to be settled in cash)		
2	Cost of construction (profit or loss) Dr.	200	
	To Bank A/c (As and when incurred)		200
	(To recognise costs relating to construction services)		
	During the operation phase:		
3	Financial asset Dr.	30	
	To Finance revenue (As and when received or due to receive)		30
	(To recognise interest income under the financial asset model)		

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4	Financial asset Dr. To Revenue [(350-220) – 30] (To recognise revenue relating to the operation phase)	100	100
5	Bank A/c Dr. To Financial asset (To recognise cash received from the grantor)	350	350

Bengaluru-Chennai Expressway Toll Project

Journal Entries

	Particulars	**Dr. (₹ in crore)**	**Cr. (₹ in crore)**
	During construction:		
1	Cost of construction (profit or loss) Dr. To Bank A/c (As and when incurred) (To recognise costs relating to construction services)	150	150
2	Intangible asset Dr. To Revenue (To recognise revenue relating to construction services provided for non-cash consideration)	200	200
	During the operation phase:		
3	Amortisation expense Dr. To Intangible asset (accumulated amortisation) (To recognise amortisation expense relating to the operation phase over the period of operation)	200	200
4	Bank A/c Dr. To Revenue (To recognise revenue relating to the operation phase)	?	?

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Note: Amount in entry 4 is kept blank as no information in this regard is given in the question.

(c) Since all customers will receive a 10% discount on purchases during the next 30 days, the only additional discount that provides the customer with a material right is the incremental discount of 30% on the products purchased. The entity accounts for the promise to provide the incremental discount as a separate performance obligation in the contract for the sale of Product A.

The entity believes there is 75% likelihood that a customer will redeem the voucher and on an average a customer will purchase ₹ 5,000 of additional products. Consequently, the entity's estimated stand-alone selling price of the discount voucher is ₹ 1,125 (₹ 5,000 average purchase price of additional products x 30% incremental discount x 75% likelihood of exercising the option). The stand-alone selling prices of Product A and the discount voucher and the resulting allocation of ₹ 10,000 transaction price are as follows:

Performance obligations	Stand-alone selling price
Product A	₹ 10,000
Discount voucher	₹ 1,125
Total	₹ 11,125

Performance obligations		**Allocated transaction price (to nearest ₹)**
Product A	[(₹ 10,000 ÷ ₹ 11,125) × ₹ 10,000]	₹ 8,989
Discount voucher	[(₹ 1,125 ÷ ₹ 11,125) × ₹ 10,000]	₹ 1,011
Total		₹ 10,000

The entity allocates ₹ 8,989 to Product A and recognises revenue for Product A when control is transferred. The entity allocates ₹ 1,011 to the discount voucher and recognises revenue for the voucher when the customer redeems it for goods or services or when it expires.

Question 3

(a) Violet Limited is a beverages manufacturing company having various plants across India. There is Machinery A in the Surat plant which is used for the purpose of bottling. There is one more machinery which is Machinery B clubbed with Machinery A. Machinery A can individually have an output and also be sold independently in the open market. Machinery B cannot be sold in isolation and without clubbing with Machinery A it cannot

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produce output as well. The company considers this group of assets as a Cash Generating Unit and an Inventory amounting to ₹ 1.65 lakhs and Goodwill amounting to ₹ 1.50 lakhs is included in such CGU.

Machinery A was purchased on 1st April 2016 for ₹ 12 lakhs and residual value is ₹ 60 thousand. Machinery B was purchased on 1st April, 2018 for ₹ 5 lakhs with no residual value. The useful life of both Machinery A and B is 10 years. The company expects following cash flows in the next 5 years pertaining to Machinery A. The incremental borrowing rate of company is 10% p.a.

Year	*Cash Flows from Machinery A*
1	*2,00,000*
2	*1,50,000*
3	*1,00,000*
4	*1,50,000*
5	*1,00,000 (Excluding Residual Value)*
Total	*7,00,000*

On 31st March, 2021, the professional valuers have estimated that the current market value of machinery A is ₹ 8.5 lakhs. There is a need to dismantle the machinery before delivering it to the buyer. Dismantling cost is ₹ 1.60 lakhs. Specialized packaging cost would be ₹ 30,000 and legal fees would be ₹ 68,000.

The inventory has been valued in accordance with Ind AS 2. The recoverable value of CGU is ₹ 10 lakhs as on 31st March, 2021. In the next year, the company has done the assessment of recoverability of the CGU and found that the value of such CGU is ₹ 11 lakhs i.e. on 31st March, 2022. The recoverable value of Machinery A is ₹ 5,50,000 and combined for Machinery A and Machinery B is ₹ 8,00,000 as on 31st March, 2022.

You are required to:

(i) Compute the impairment loss on CGU and carrying value of each asset after charging impairment loss for the year ending 31st March, 2021 by providing all the relevant working notes to arrive at such calculation.

(ii) Compute the carrying value after considering prospective depreciation for the year 2021-2022 on the above assets.

(iii) Compute the carrying value of CGU as at 31st March, 2022.

(Note: Present value factor of ₹ 1 should be taken upto 4 decimals for the purpose of calculation) ***(8 Marks)***

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(b) Following is the summarized Statement of Profit and Loss of New Age Ltd. as per Ind AS for the year ended 31.3.2022:

Particulars	*₹ in lakhs*
Revenue from operations	*1,450.00*
Other income	*70.00*
(A) Total income	*1,520.00*
Purchase of stock in trade	*50.00*
Changes in inventories of stock in trade	*20.00*
Employee benefit expenses	*145.00*
Finance costs	*180.00*
Other expenses	*375.00*
(B) Total expenses	*770.00*
(C) Profit before tax (A - B)	*750.00*
(D) Current tax expense	*211.65*
(E) Profit after tax (C - D)	*538.35*

Additional information:

(1) Consider that Income tax rate applicable to New Age Ltd. in India is 30%.

(2) 'Other expenses' include the following expenses which are not deductible for income tax purposes:

(i) Penalties ₹ 1.50 lakh

(ii) Donations ₹ 55.00 lakhs

(iii) Impairment of goodwill ₹ 7.00 lakhs

(3) 'Other expenses' also include expenditure on Scientific Research amounting to ₹ 10 lakhs in respect of which a 150% weighted deduction is available under income tax laws.

(4) 'Other income' includes:

(i) Dividends of ₹ 5 lakhs, which is exempt from tax.

(ii) Long term capital gains of ₹ 12 lakhs which are taxable at the rate of 10%.

(5) 'Profit before tax of ₹ 750 lakhs' includes:

(i) Agriculture income of ₹ 65 lakhs which is exempt from tax; and

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(ii) Profit of ₹ 75 lakhs earned in USA on which New Age Ltd. has paid tax at the rate of 20%.

During review of financial statements of New Age Ltd., the CFO multiplied profit before tax by the income tax rate and arrived at ₹ 225 lakhs as the tax expenses. However, the actual income tax expenses appearing in the summarized Statement of Profit and Loss is ₹ 211.65 lakhs.

You are required to help the CFO of the company in reconciling the difference between the tax expense amount. ***(6 Marks)***

(c) Explain the criteria in the Conceptual Framework for Financial Reporting for the recognition of an asset and discuss whether there are inconsistencies with the criteria in Ind AS 38. ***(6 Marks)***

OR

State the categories of capital as defined in the Integrated Reporting Framework. Can an integrated reporting be done in compliance to the requirements of the local laws to prepare a management commentary or other reports? ***(6 Marks)***

Answer

(a) (i) Computation of impairment loss and carrying value of each of the asset in CGU after impairment loss

(a) Calculation of carrying value of Machinery A and B before impairment

Machinery A		
Cost	(A)	₹ 12,00,000
Residual value		₹ 60,000
Useful life		10 years
Useful life already elapsed		5 years
Yearly depreciation	(B)	₹ 1,14,000
WDV as at 31st March 2021 [A- (B x 5)]		₹ 6,30,000
Machinery B		
Cost	(C)	₹ 5,00,000
Residual value		-
Useful life		10 years
Useful life already elapsed		3 years
Yearly depreciation	(D)	₹ 50,000
WDV as at 31st March 2021 [C- (D x 3)]		₹ 3,50,000

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(b) Calculation of Value-in-use of Machinery A

Period	Cash Flows (₹)	PVF@10%	PV
1	2,00,000	0.9091	1,81,820
2	1,50,000	0.8264	1,23,960
3	1,00,000	0.7513	75,130
4	1,50,000	0.6830	1,02,450
5	1,00,000	0.6209	62,090
5	60,000	0.6209	37,254
Value in use			5,82,704

(c) Calculation of Fair Value less cost of disposal of Machinery A

	₹
Fair Value	8,50,000
Less: Dismantling cost	(1,60,000)
Packaging cost	(30,000)
Legal Fees	(68,000)
Fair value less cost of disposal	5,92,000

(d) Calculation of Impairment loss on Machinery A

	₹
Carrying Value	6,30,000
Less: Recoverable Value ie higher of Value-in-use (₹ 5,82,704) and Fair value less cost of disposal (₹ 5,92,000)	(5,92,000)
Impairment Loss	38,000

(e) Calculation of Impairment loss of CGU

1. First goodwill will be impaired fully and then the remaining impairment loss of CGU will be allocated to Machinery A and Machinery B.

2. After deduction of value of goodwill ₹ 1,50,000 from total impairment loss of CGU of ₹ 2,95,000, remaining impairment loss would be ₹ 1,45,000. If we allocate remaining impairment loss to Machinery A and B on pro-rata basis, it will come to ₹ 93,214 on Machinery A. However, the impairment loss of Machinery A cannot exceed ₹ 38,000 since its recoverable value is ₹ 5,92,000. Hence, impairment loss to CGU will be as follows:

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	Carrying value before impairment loss	Impairment loss	Carrying value after impairment loss
	₹	₹	₹
Machinery A	6,30,000	38,000	5,92,000
Machinery B	3,50,000	1,07,000*	2,43,000
Inventory	1,65,000	-	1,65,000
Goodwill	1,50,000	1,50,000	-
Total	12,95,000	2,95,000	10,00,000

* Balancing figure.

(ii) Carrying value after adjustment of depreciation of 2021-2022

	₹
Machinery A [5,92,000 – {(5,92,000 - 60,000)/5}]	4,85,600
Machinery B [2,43,000 – (2,43,000/7)]	2,08,286
Inventory	1,65,000
Goodwill	-
Total	8,58,886

(c) Calculation of carrying value of CGU as on 31st March 2022

The revised value of CGU is ₹ 11 lakh. However, impaired goodwill cannot be reversed. Further, the individual assets cannot be increased above the lower of recoverable value or carrying value as if the assets were never impaired.

Accordingly, the carrying value as on 31st March 2022 assuming that the impairment loss had never incurred, will be:

	Carrying Value	Recoverable Value	Final CV as at 31st March 2022
Machinery A	[12,00,000 - (1,14,000 x 6)] 5,16,000	5,50,000	5,16,000
Machinery B	[5,00,000 – (50,000x4)] 3,00,000	(8,00,000 – 5,50,000) 2,50,000	2,50,000
Inventory	1,65,000*	1,65,000*	1,65,000*
Goodwill	-	-	-
Total	9,81,000	9,65,000	9,31,000

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Hence, the impairment loss to be reversed will be limited to ₹ 72,114 only (₹ 9,31,000 – ₹ 8,58,886).

*Note: The question required valuation of CGU at the year-end 31st March 2022, for which value of inventory was required. In the absence of the value of inventory for the year ended 31st March 2022, it is assumed that the value of inventory for the year ended 31st March 2022 is same as it was for the year ended 31st March, 2021.

(b) Reconciliation of income tax expense and current tax as per accounting profit for the year ended 31st March 2022

Particulars		₹ in lakhs
Accounting profit		750.00
Tax at the applicable tax rate of 30%		225.00
Tax effect of expenses that are not deductible in determining taxable profits:		
Penalties (1.5 x 30%)	0.45	
Impairment of goodwill (7 x 30%)	2.10	
Donations (55 x 30%)	16.50	19.05
Tax effect of expenses that are deductible in determining taxable profits:		
Expenditure on scientific research (10.00 x 50% x 30%)		(1.50)
Tax effect of income that are exempted in determining taxable profits:		
Dividend income (Exempt) (5.00 x 30%)	1.50	
Agriculture income (Exempt) (65.00 x 30%)	19.50	(21.00)
Tax effect of income on which different tax rates are used for determining taxable profits:		
Differential income tax on long term capital gain [12.00 x (30% - 10%)]	2.40	
Foreign income in USA [75.00 x (30% - 20%)]	7.50	(9.90)
Income tax expense (Current) reported in the Statement of Profit and Loss for the current year		211.65

(c) Either

The Conceptual Framework defines an asset as a present economic resource controlled by the entity as a result of past events. An economic resource is a right that has the potential to produce economic benefits. Assets should be recognized if they meet the

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Conceptual Framework definition of an asset and such recognition provides users of financial statements with information that is useful i.e. it is relevant as well as results in faithful representation. However, the criteria of a cost-benefit analysis always exists i.e. the benefits of the information must be sufficient to justify the costs of providing such information. The recognition criteria outlined in the Conceptual Framework allows for flexibility in the application in amending or developing the standards.

Para 8 of Ind AS 38 'Intangible Assets', defines an intangible asset as an identifiable non-monetary asset without physical substance. Further, Ind AS 38 defines an asset as a resource:

(a) controlled by an entity as a result of past events; and

(b) from which future economic benefits are expected to flow to the entity.

Furthermore, Para 21 of Ind AS 38 states that an intangible asset shall be recognised if, and only if:

(a) it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and

(b) the cost of the asset can be measured reliably.

This requirement is applicable both in case of an externally acquired intangible asset or an internally generated intangible asset. The probability of expected future economic benefits must be based on reasonable and supportable assumptions that represent management's best estimate of the set of economic conditions that will exist over the useful life of the asset. Further, as per Para 33 of Ind AS 38, the probability recognition criterion is always considered to be satisfied for intangible assets acquired in business combinations. If the recognition criteria are not satisfied, Ind AS 38 requires the expenditure to be expensed as and when it is incurred.

It is notable that the Conceptual Framework does not prescribe a 'probability criterion'. As long as there is a potential to produce economic benefits, even with a low probability, an item can be recognized as an asset according to the Conceptual Framework. However, in terms of intangible assets, it could be argued that recognizing an intangible asset having low probability of generating economic benefits would not be useful to the users of financial statements given that the asset has no physical substance.

The recognition criteria and definition of an asset under Ind AS 38 are different as compared to those outlined in the Conceptual Framework. To put in simple words, the criteria in Ind AS 38 are more specific, but definitely do provide information that is relevant and a faithful representation. When viewed from the prism of relevance and faithful representation, the requirements of Ind AS 38 in terms of recognition appear to be consistent with the Conceptual Framework.

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(c) Or

The Integrated Reporting Framework has categorised the capital into 6 main forms. However, at the same time, it stresses upon that not necessary the same categorisation of capital be followed by the entities in their integrated reporting.

1. **Financial Capital:** The pool of funds available to an organization for use in the production of goods or the provision of services obtained through financing, such as debt, equity or grants; or generated through operations or investments.
2. **Manufactured Capital:** Manufactured physical objects (as distinct from natural physical objects) that are available to an organization for use in the production of goods or the provision of services, including buildings, equipment and infrastructure (such as roads, ports, bridges, and waste and water treatment plants).
3. **Intellectual Capital:** Organizational, knowledge-based intangibles, including intellectual property, such as patents, copyrights, software, rights and licences and organizational capital such as tacit knowledge, systems, procedures and protocols.
4. **Human Capital:** People's competencies, capabilities and experience, and their motivations to innovate, including their loyalties and motivations for improving processes, goods and services, including their ability to lead, manage and collaborate.
5. **Social and Relationship Capital:** The institutions and the relationships within and between communities, groups of stakeholders and other networks, and the ability to share information to enhance individual and collective well-being.
6. **Natural Capital:** All renewable and non-renewable environmental resources and processes that provide goods or services that support the past, current, or future prosperity of an organization.

An integrated report may be prepared in response to existing compliance requirements. For example, an organization may be required by local law to prepare a management commentary or other report that provides context for its financial statements. If that report is also prepared in accordance with this Framework, it can be considered an integrated report. If the report is required to include specified information beyond that required by this Framework, the report can still be considered an integrated report if that other information does not obscure the concise information required by this Framework.

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Question 4

(a) *On 1st April, 2021 "Fortunate Bank" has provided a loan of ₹25,00,000 to Mohan Limited for 4 years at 10% p.a. and the loan has been guaranteed by Surya Limited, which is a holding company for Mohan Limited. Interest payments are made at the end of each year and the principal is repaid at the end of the loan term. If Surya Limited had not issued a guarantee, 'Fortunate Bank' would have charged Mohan Limited an interest rate of 14% p.a. Surya Limited does not charge Mohan Limited for providing the guarantee.*

On 31st March 2022, there is 2% probability that Mohan Limited may default on the loan in the next 12 months. If Mohan Limited defaults on the loan, Surya Limited does not expect to recover any amount from Mohan Limited.

On 31st March 2023, there is 4% probability that Mohan Limited may default on the loan in the next 12 months. If Mohan Limited defaults on the loan, Surya Limited does not expect to recover any amount from Mohan Limited.

On 31st March 2024, there is 5% probability that Mohan Limited may default on the loan in the next 12 months. If Mohan Limited defaults on the loan, Surya Limited does not expect to recover any amount from Mohan Limited.

You are required to provide accounting treatment of financial guarantee as per Ind AS 109 in the books of Surya Limited on initial recognition and in subsequent periods till 31st March, 2024. ***(12 Marks)***

(b) *Lessee enters into a 10 years lease for 6000 square metres of office space. The annual lease payments are ₹1,00,000 payable at the end of each year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 8% p.a. At the beginning of the 6th year, lessee and lessor agree to amend the original lease to reduce the space to only 3,000 square metres of the original space starting from the first quarter of year 6. The annual fixed lease payments (from year 6 to year 10) are ₹ 60,000. Lessee's incremental borrowing rate at-the beginning of year 6 is 6% p.a.*

You are required to analyse the effect of the said modification and give journal entries for the same in the books of Lessee.

Note: Give your calculation by adopting the present value factor as:

Year	1	2	3	4	5	6	7	8	9	10
8%	0.9259	0.8573	0.7938	0.7350	0.6806	0.6302	0.5835	0.5403	0.5002	0.4632
6%	0.9434	0.8900	0.8396	0.7921	0.7473	0.7050	0.6651	0.6274	0.5919	0.5584

(8 Marks)

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Answer

(a) 1st April 2021

A financial guarantee contract is initially recognised at fair value. The fair value of the guarantee will be the present value of the difference between the net contractual cash flows required under the loan, and the net contractual cash flows that would have been required without the guarantee.

Particulars	Year 1 (₹)	Year 2 (₹)	Year 3 (₹)	Year 4 (₹)	Total (₹)
Cash flows based on interest rate of 14% (A)	3,50,000	3,50,000	3,50,000	3,50,000	14,00,000
Cash flows based on interest rate of 10% (B)	2,50,000	2,50,000	2,50,000	2,50,000	10,00,000
Interest on differential rate (C) = (A-B)	1,00,000	1,00,000	1,00,000	1,00,000	4,00,000
Discount factor @ 14%	0.877	0.769	0.675	0.592	
Interest on differential rate discounted @ 14%	87,700	76,900	67,500	59,200	2,91,300
Fair value of financial guaranteed contract (at inception)					2,91,300

Alternative manner of presentation for the calculation of fair value of financial guaranteed contract (at inception)

(i) Interest on loan @ 10% = ₹ 2,50,000

Present value of cash flow of loan at concessional rate with guarantee @ 14%

= ₹ 2,50,000 x 2.9138 + ₹ 25,00,000 x 0.5921

= ₹ 7,28,450 + ₹ 14,80,250 = ₹ 22,08,700

(ii) Interest on loan at normal rate of 14% = ₹ 3,50,000

Present Value of Cash flow of loan at 14%

= ₹ 3,50,000 x 2.9138 + ₹ 25,00,000 x 0.5921

= ₹ 25,00,080 or ₹ 25,00,000

Difference (ii) – (i) = ₹ 25,00,000 - ₹ 22,08,700

Fair value of financial guaranteed contract (at inception) = ₹ 2,91,300

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Journal Entry

Particulars		Debit (₹)	Credit (₹)
Investment in subsidiary	Dr.	2,91,300	
To Financial guarantee (liability)			2,91,300
(Being financial guarantee initially recorded)			

31st March 2022

Subsequently at the end of the reporting period, financial guarantee is measured at the higher of:

- the amount of loss allowance; and
- the amount initially recognised less cumulative amortization, where appropriate.

At 31st March 2022, there is 2% probability that Mohan Limited may default on the loan in the next 12 months. If Mohan Limited defaults on the loan, Surya Limited does not expect to recover any amount from Mohan Limited. The 12-month expected credit losses are therefore ₹ 50,000 (₹ 25,00,000 x 2%).

The initial amount recognised less amortisation is ₹ 2,32,082 (Refer table below). The unwound amount is recognised as income in the books of Surya Limited, being the benefit derived by Mohan Limited not defaulting on the loan during the period.

Year ended on 31st March	Opening balance (a) ₹	EIR @ 14% (b) = (a x 14%)	Benefits provided (c) ₹	Closing balance (d) = (a) + (b) -(c) ₹
2022	2,91,300	40,782	(1,00,000)	**2,32,082**
2023	2,32,082	32,491	(1,00,000)	1,64,573
2024	1,64,573	23,040	(1,00,000)	87,613
2025	87,613	12,387*	(1,00,000)	-

* Difference of ₹ 121 (₹ 12,387 – ₹ 12,266) is due to approximation.

The carrying amount of the financial guarantee liability after amortisation is therefore ₹ 2,32,082, which is higher than the 12-month expected credit losses of ₹ 50,000. The liability is therefore adjusted to ₹ 2,32,082 (the higher of the two amounts) as follows:

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Particulars		Debit (₹)	Credit (₹)
Financial guarantee (liability)	Dr.	59,218	
To Profit and loss			59,218
(Being financial guarantee subsequently adjusted)			

31st March 2023

At 31st March 2023, there is 4% probability that Mohan Limited will default on the loan in the next 12 months. If Mohan Limited defaults on the loan, Surya Limited does not expect to recover any amount from Mohan Limited. The 12-month expected credit losses are therefore ₹ 1,00,000 (₹ 25,00,000 x 4%).

The carrying amount of the financial guarantee liability after amortisation is ₹ 1,64,573, which is higher than the 12-month expected credit losses of ₹ 1,00,000. The liability is therefore adjusted to ₹ 1,64,573 (the higher of the two amounts) as follows:

Particulars		Debit (₹)	Credit (₹)
Financial guarantee (liability)	Dr.	67,509	
To Profit and loss			67,509
(Being financial guarantee subsequently adjusted)			

31st March 2024

At 31st March 2024, there is 5% probability that Mohan Limited will default on the loan in the next 12 months. If Mohan Limited defaults on the loan, Surya Limited does not expect to recover any amount from Mohan Limited. The 12-month expected credit losses are therefore ₹ 1,25,000 (₹ 25,00,000 x 5%).

The initial amount recognised less accumulated amortisation is ₹ 87,613, which is lower than the 12-month expected credit losses (₹ 1,25,000). The liability is therefore adjusted to ₹ 1,25,000 (the higher of the two amounts) as follows:

Particulars		Debit (₹)	Credit (₹)
Financial guarantee (liability)	Dr.	39,573*	
To Profit and loss (Refer Note below)			39,573*
(Being financial guarantee subsequently adjusted)			

* Note: The carrying amount at the end of 31st March 2023 will be ₹ 1,25,000 (i.e. ₹ 1,64,573 less 12-month expected credit losses of ₹ 39,573).

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(b) In the books of Lessee

Calculation of ROU asset and lease liability before modification: (in ₹)

Year	Lease Liability				ROU asset		
	Initial value	Lease payments	Interest expense @ 8%	Closing balance	Initial Value	Depreciation	Closing balance
	a	b	c = a x 8%	d = a-b + c	e	F	g
1	6,71,000 (Refer W.N.)	1,00,000	53,680	6,24,680	6,71,000	67,100	6,03,900
2	6,24,680	1,00,000	49,974	5,74,654	6,03,900	67,100	5,36,800
3	5,74,654	1,00,000	45,972	5,20,626	5,36,800	67,100	4,69,700
4	5,20,626	1,00,000	41,650	4,62,276	4,69,700	67,100	4,02,600
5	4,62,276	1,00,000	36,982	3,99,258	4,02,600	67,100	3,35,500
6	3,99,258				3,35,500		

At the effective date of the modification (at the beginning of Year 6), Lessee remeasures the lease liability based on:

(a) A five-year remaining lease term,

(b) Annual payments of ₹ 60,000 and

(c) Lessee's incremental borrowing rate of 6% p.a.

Year	Lease Payment(A)	Present value factor @ 6% (B)	Present value of lease payments (A x B = C)
6	60,000	0.9434	56,604
7	60,000	0.8900	53,400
8	60,000	0.8396	50,376
9	60,000	0.7921	47,526
10	60,000	0.7473	44,838
Total			2,52,744

Alternative manner of above calculation:

Annual lease payments x Sum of PVF from year 6th year to 10th year @ 6% discount rate

= ₹ 60,000 x 4.2124 = ₹ 2,52,744

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Lessee determines the proportionate decrease in the carrying amount of the ROU Asset on the basis of the remaining ROU Asset (i.e., 3,000 square metres corresponding to 50% of the original ROU Asset).

50% of the pre-modification ROU Asset (₹ 3,35,500) is ₹ 1,67,750.

50% of the pre-modification lease liability (₹ 3,99,258) is ₹ 1,99,629.

Consequently, lessee reduces the carrying amount of the ROU Asset by ₹ 1,67,750 and the carrying amount of the lease liability by ₹ 1,99,629 and recognises the difference between the decrease in the lease liability and the decrease in the ROU Asset (₹ 1,99,629 – ₹ 1,67,750 = ₹ 31,879) as a gain in profit or loss account at the effective date of the modification (at the beginning of Year 6).

Journal Entry

Particulars		Debit (₹)	Credit (₹)
Lease Liability	Dr.	1,99,629	
To ROU Asset			1,67,750
To Profit & Loss			31,879

Lessee recognises the difference between the reduced 50% lease liability of ₹ 1,99,629 and the modified lease liability of ₹ 2,52,744 (which equals ₹ 53,115) as an adjustment to the ROU Asset reflecting the change in the consideration paid for the lease and the revised discount rate.

Journal Entry

Particulars		Debit (₹)	Credit (₹)
ROU Asset	Dr.	53,115	
To Lease Liability			53,115

Working Note:

Calculation of Initial value of ROU asset and lease liability:

Year	Lease Payment(A)	Present value factor @ 8% (B)	Present value of lease payments (A x B = C)
1	1,00,000	0.9259	92,590
2	1,00,000	0.8573	85,730
3	1,00,000	0.7938	79,380
4	1,00,000	0.7350	73,500
5	1,00,000	0.6806	68,060

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6	1,00,000	0.6302	63,020
7	1,00,000	0.5835	58,350
8	1,00,000	0.5403	54,030
9	1,00,000	0.5002	50,020
10	1,00,000	0.4632	46,320
			6,71,000

Alternative manner of above calculation:

Annual lease payments x Sum of PVF from year 1 to 10 @ 8% discount rate

= ₹ 1,00,000 x 6.71 = ₹ 6,71,000

Note: It is assumed that even after modification, annual lease payment will continue to be made at the end of the year as mentioned under the original terms of the lease.

Question 5

(a) A herd of 15, 4 year old cows valued at ₹ 500 thousands per cow were held in 'M Dairy Farm' as at 1st April 2021. The following transactions took place on 1st October, 2021:

(A) One cow aged 4.5 years was purchased for ₹ 520 thousands.

(B) One calf was born.

No cow was sold or disposed off during the year.

The per cow/calf fair value less cost to sell was as follows: *₹ in thousands*

4 year old cow on 1st April 2021	*500*
New born calf on 1st October 2021	*400*
4.5 year old cow on 1st October 2021	*520*
New born calf on 31st March, 2022	*410*
0.5 year old calf on 31st March, 2022	*440*
4 year old cow on 31st March, 2022	*516*
4.5 year old cow on 31st March, 2022	*540*
5 year old cow on 31st March, 2022	*560*

You are required to:

(i) Calculate change in fair value less costs to sell showing:

(a) The portion attributable to physical changes

(b) The portion attributable to price changes.

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(ii) *Calculate the carrying cost of the herd as on 31st March, 2022.*

(iii) *Prepare an extract of the livestock account for the year ended 31st March, 2022.*

(6 Marks)

(b) *Jackson Limited is engaged in manufacturing and trading activities. It is in the process of preparation of consolidated financial statements of the group for the year ended on 31st March 2022. During the year 2021-2022, the company made a profit (after tax) of ₹ 2,10,00,000 of which ₹ 10,00,000 is attributable to Non-Controlling Interest (NCI).*

The long-term finance of the company comprises the following:

(A) *10 crore equity shares of ₹ 1 each at the beginning of the year and the company has further issued 2,50,00,000 shares on 1st October 2021 at full market value.*

(B) *40 lakh irredeemable preference shares of ₹ 10 each. These shares were in issue for the whole of the year ended 31st March 2022. The payment of dividend on these preference shares is discretionary.*

(C) *₹ 9 crore of 6% convertible debentures issued on 1st April, 2020 and repayable on 31st March, 2025 at par. Interest is payable annually. As an alternative to repayment at par, the holder on maturity can elect to exchange their convertible debentures for 5 crore ordinary shares in the company. On 1st April, 2021* the prevailing market interest rate for 5 yearly convertible debentures which had no right of conversion was 8%. Using an annual discount rate of 8%, the present value of ₹ 1 payable in five years is 0.68 and the cumulative present value of ₹ 1 payable at the end of years one to five is 3.99.*

In the year ended 31st March, 2022 Jackson Limited declared a dividend of ₹ 0.10 per share on the irredeemable preference shares.

You are required to:

(i) *Compute the finance cost of convertible debentures and its closing balance as on 31st March, 2022 to be presented in the consolidated financial statements.*

(ii) *Compute the basic and diluted earnings per share for the year ended 31st March, 2022. Assume that applicable income tax rate is 30% for Jackson Limited and its subsidiaries.* ***(8 Marks)***

*** PS:** Read '1st April, 2021' as '1st April, 2020'.

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(c) On 1st April, 2019, Sun Ltd. issued share-based option to one of its key managerial personnel (employee) which can be exercised either in cash or equity and it has following features:

Option I

No. of cash settled shares	*70,000*
Service condition	*3 years*

Option II

No. of equity settled shares of face value of ₹100 each	*80,000*

Conditions:

Service	*3 years*
Restriction to sell	*2 years*

Fair Values

Share alternative fair value (with restriction)	*₹125*
Fair value at grant date	*₹136*
Fair value on 31st March, 2020	*₹141*
Fair value on 31st March, 2021	*₹143*
Fair value on 31st March, 2022	*₹146*

You are required to pass the journal entries if the key managerial employee exercises cash option at the end of 31st March, 2022 and also if he exercises equity option at the end of 31st March, 2022. ***(6 Marks)***

Answer

(a) (i) Change in fair value less costs to sell, due to physical change and price change:

₹ in thousand

Fair value less costs to sell of herd at 1st April 2021 (15 × 500)			7,500
Purchase on 1st October 2021 (1 x 520)			520
(a)	**Increase in fair value less costs to sell due to price change:**		
	15 cows x (516 – 500)	240	
	1 cows x (540 – 520)	20	
	1 calf x (410 – 400)	10	270

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(b)	**Increase in fair value less costs to sell due to physical change:**		
	15 cows x (560 – 516)	660	
	1 cows x (560 – 540)	20	
	1 calf x (440 – 410)	30	
	1 calf x 400 (Gain on initial recognition)	400	1,110
			9,400

(ii) Calculation of carrying cost of herd as on 31st March 2022 i.e.

Fair value less costs to sell of herd at 31st March 2022

16 × 560	8,960	
1 × 440	440	9,400

(iii) Extract of Livestock Account for the year 31st March 2022

Particulars	Amount (₹ in 000)	Particulars	Amount (₹ in 000)
To Opening Stock	7500	By Closing Balance	9,400
To Purchases (1x520)	520		
To Increase in fair value (Price Changes)	270		
To Increase in fair value (Physical Changes)	1,110		
Total	9,400	Total	9,400

(b) (i) Calculation of the liability and equity components on 6% Convertible debentures:

Present value of principal payable at the end of 5th year (₹ 90,000 thousand x 0.68)

= ₹ 61,200 thousand

Present value of interest payable annually for 5 years (₹ 90,000 thousand x 6% x 3.99)

= ₹ 21,546 thousand

Total liability component = ₹ 82,746 thousand

Therefore, equity component = ₹ 90,000 thousand – ₹ 82,746 thousand

= ₹ 7,254 thousand

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Calculation of finance cost and closing balance of 6% convertible debentures

Year	Opening balance ₹ in '000	Finance cost @ 8% ₹ in '000	Interest paid @ 6% ₹ in '000	Closing balance ₹ in '000
	a	b = a x 8%	c	d = a + b - c
31.3.2021	82,746	6,620	5,400	83,966
31.3.2022	83,966	6,717	5,400	85,283

Finance cost of convertible debentures for the year ended 31.3.2022 is ₹ 6,717 thousand and closing balance as on 31.3.2022 is ₹ 85,283 thousand.

(ii) (a) Calculation of Basic EPS **₹ in '000**

Profit for the year attributable to parent company	20,000
Less: Dividend on preference shares (4,000 thousand x ₹ 0.10)	(400)
Profit attributable to equity shareholders	19,600

Weighted average number of shares = 10,00,00,000 + {2,50,00,000 x (6/12*)}

= 11,25,00,000 shares or 1,12,500 thousand shares

Basic EPS = ₹ 19,600 thousand / 1,12,500 thousand shares

= ₹ 0.174

(b) Calculation of Diluted EPS **₹ in '000**

Profit for the year		20,000
Less: Dividend on preference shares (4,000 x 0.10)		(400)
		19,600
Add: Finance cost (as given in the above table)	6,717.00	
Less: Tax @ 30%	(2,015.10)	4,701.90
		24,301.90

Weighted average number of shares = 10,00,00,000 + {2,50,00,000 x (6/12)*} + 5,00,00,000

= 16,25,00,000 shares or 1,62,500 thousand shares

Diluted EPS = ₹ 24,301.90 thousand / 1,62,500 thousand shares = ₹ 0.150

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(c)

	1st April 2019 (₹)	31st March 2020 (₹)	31st March 2021 (₹)	31st March 2022 (₹)
Equity alternative (80,000 x 125)	1,00,00,000			
Cash alternative (70,000 x 136)	95,20,000			
Equity option (1,00,00,000 – 95,20,000)	4,80,000			
Cash option (cumulative) (using period end fair value		(70,000 x 141 x 1/3)	(70,000 x 143 x 2/3)	(70,000 x 146 x 3/3)
		32,90,000	66,73,333	1,02,20,000
Equity option (cumulative)		(4,80,000 x 1/3)	(4,80,000 x 2/3)	(4,80,000 x 3/3)
		1,60,000	3,20,000	4,80,000

Expense for the period			
Equity option	1,60,000	(3,20,000 – 1,60,000) 1,60,000	(4,80,000 – 3,20,000) 1,60,000
Cash Option	32,90,000	(66,73,333 – 32,90,000) 33,83,333	(1,02,20,000 – 66,73,333) 35,46,667
Total	34,50,000	35,43,333	37,06,667

Journal Entries

(i) If Cash alternative is chosen:		₹	₹
Share based payment liability	Dr.	1,02,20,000	
To Bank/ Cash			1,02,20,000
(Settlement in cash)			
Share based payment reserve (equity)*	Dr.	4,80,000	
To Retained earnings			4,80,000
(Being transfer of equity from one account to another one)			

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(ii) If Equity alternative is chosen:			
Share based payment liability	Dr.	1,02,20,000	
To Share based payment reserve (equity)			1,02,20,000
(Being transfer of liability account to equity)			
Share based payment reserve (equity)	Dr.	1,07,00,000	
To Capital			80,00,000
To Securities Premium			27,00,000
(Being settlement made in equity)			
Alternative entries under equity settlement:			
(ii) If Equity alternative is chosen:			
Share based payment liability	Dr.	1,02,20,000	
To Share Capital			80,00,000
To Securities Premium			22,20,000
(Being settlement made in equity)			
Share based payment reserve (equity)*	Dr.	4,80,000	
To Retained earnings			4,80,000
(Being transfer of equity from one account to another one)			

*The equity component recognized (₹ 4,80,000) shall remain within equity.

Question 6

(a) *Orange Ltd. is going to prepare its annual financial statements for the year ending 31st March, 2022, in the process it discovered that a provision for constructive obligation for payment of bonus to selected employees in the corporate office (material in amount) which was required to be recognized in the annual financial statements for the year ended 31st March, 2020 was not recognized due to oversight of facts. The bonus was paid during the financial year ended 31st March, 2021 and was recognized as an expense in the annual financial statements for the said year.*

As a finance manager of the company, you are required to analyse whether the situation relating to constructive obligation for payment of bonus is an error requiring retrospective restatement of comparatives considering that the amount is material. ***(5 Marks)***

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(b) *ENG Ltd. has developed model to measure the expected credit loss based on the lifetime expected credit loss model. Accordingly, the company has estimated the following provisioning matrix:*

	Current	1-30 days past due	31-60 days past due	61-90 days past due	More than 90 days past due
Default Rate	0.3%	1.6%	3.6%	6.6%	10.6%

The Company has a portfolio of trade receivables of ₹ 6 crores as on 31st March, 2022 and operates in only one geographical region. The customer base of the company consists of large number of small clients and trade receivables are categorized by common risk characteristics that are representative of customer's abilities to pay all amounts due as per the contractual terms.

The trade receivables do not have significant financing component. The above provision matrix is based on its historically observed default rate over the expected life of the trade receivables and is adjusted for forward looking estimate.

The company has asked you to suggest whether the above system of making the provision for the expected credit loss is in accordance with the applicable Ind AS? If yes, then determine the expected credit loss for the Trade Receivables outstanding as on 31st March, 2022 on the following basis:

	Current	1-30 days past due	31-60 days past due	61-90 days past due	More than 90 days past due
% of Trade Receivables	50%	25%	13%	8%	4%

(5 Marks)

(c) *Pharmaceuticals Limited has 5 operating segments namely K, L, M, N and O. The profit/ loss of respective segments for the year ended 31st March, 2022 are as follows:*

Segment	Profit / (Loss) (₹ in crore)
K	1,560
L	3,000
M	(4,600)
N	(9,000)
O	12,000
Total	2,960

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Based on the quantitative thresholds, you are required to determine that which of the above segments would be considered as reportable segments for the year ending 31st March, 2022. ***(5 Marks)***

(d) *On 1st April 2021, Honey Limited acquired 40% interest in another entity, Smart Limited. Honey Limited determines that it is able to exercise significant influence over Smart Ltd. Honey Limited has paid total consideration of ₹ 95,00,000 for acquiring the interest in Smart Ltd. On the date of acquisition, the book value of Smart Ltd.'s net assets was ₹ 1,80,00,000 and their fair value was ₹ 2,20,00,000. Honey Ltd. has determined that the difference of ₹ 40,00,000 pertains to an item of property, plant and equipment which has remaining useful life of 10 years.*

During the year 2021-2022, Smart Ltd. made a profit of ₹ 16,00,000. Smart Limited paid a dividend of ₹ 24,00,000 on 31st March, 2022. Smart Limited also holds a long-term investment in equity securities. Under Ind AS, investment is classified as at FVTOCI in accordance with Ind AS 109 and Smart Ltd. recognized an increase in value of investment by ₹ 4,00,000 in OCI during the year. Ignore deferred tax implications, if any.

You are required to ascertain the closing balance of Honey Limited' s investments in Smart Limited as at 31st March, 2022 as per the relevant Ind AS. (Use equity method)

(5 Marks)

Answer

(a) As per paragraph 41 of Ind AS 8, errors can arise in respect of the recognition, measurement, presentation or disclosure of elements of financial statements. Financial statements do not comply with Ind AS if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity's financial position, financial performance or cash flows. Potential current period errors discovered in that period are corrected before the financial statements are approved for issue. However, material errors are sometimes not discovered until a subsequent period, and these prior period errors are corrected in the comparative information presented in the financial statements for that subsequent period.

As per paragraph 40A of Ind AS 1, an entity shall present a third balance sheet as at the beginning of the preceding period in addition to the minimum comparative financial statements if, inter alia, it makes a retrospective restatement of items in its financial statements and the retrospective restatement has a material effect on the information in the balance sheet at the beginning of the preceding period.

In the given case, expenses for the year ended 31st March, 2020 and liabilities as at 31st March, 2020 were understated because of non-recognition of bonus expense and related provision. Expenses for the year ended 31st March, 2021, on the other hand,

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were overstated to the same extent because of recognition of the aforesaid bonus as expense for the year. To correct the above errors in the annual financial statements for the year ended 31st March, 2022, the entity should:

(a) restate the comparative amounts (i.e., those for the year ended 31st March, 2021) in the statement of profit and loss; and

(b) present a third balance sheet as at the beginning of the preceding period (i.e., as at 1st April, 2020) wherein it should recognise the provision for bonus and restate the retained earnings.

(b) To determine the expected credit losses for the portfolio, ENG Ltd. should use a provision matrix. The provision matrix will be based on its historical observed default rates over the expected life of the trade receivables and shall be adjusted for forward-looking estimates. At every reporting date the historical observed default rate shall be updated and changes in the forward-looking estimates shall be analysed. In this case, it is forecast that economic conditions will deteriorate over the next year. Therefore, as per para 5.5.15 of Ind AS 109, the loss allowance for trade receivables shall be measured at an amount equal to lifetime expected credit losses. On that basis, ENG Ltd. estimates the provision matrix.

The trade receivables from the large number of small customers amount to ₹ 6,00,00,000 and are measured using the provision matrix:

	Provision % age	Gross carrying amount	Default rate	Lifetime expected credit loss allowance (Gross carrying amount x lifetime expected credit loss rate)
a	b	C = ₹ 6 crore x b	d	e = c x d
		₹		₹
Current	50%	3,00,00,000	0.3%	₹ 90,000
1–30 days past due	25%	1,50,00,000	1.6%	₹ 2,40,000
31–60 days past due	13%	78,00,000	3.6%	₹ 2,80,800
61–90 days past due	8%	48,00,000	6.6%	₹ 3,16,800
More than 90 days past due	4%	24,00,000	10.6%	₹ 2,54,400
		6,00,00,000		₹ 11,82,000

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(c) With regard to quantitative thresholds to determine reportable segment relevant in context of instant case, paragraph 13(b) of Ind AS 108 'Operating Segments' may be noted which provides as follows:

"The absolute amount of its reported profit or loss is 10 per cent or more of the greater, in absolute amount, of (i) the combined reported profit of all operating segments that did not report a loss and (ii) the combined reported loss of all operating segments that reported a loss."

In compliance with Ind AS 108, the segment profit/loss of respective segment will be compared with the greater of the following:

(i) All segments in profit, i.e., K, L and O – Total profit ₹ 16,560 crores.

(ii) All segments in loss, i.e., M and N – Total loss ₹ 13,600 crores.

Greater of the above – ₹ 16,560 crores.

Based on the above, reportable segments will be determined as follows:

Segment	Profit/(Loss) (₹ in crore)	% age of ₹ 16,560 crore*	Reportable segment
K	1,560	9.42%	No
L	3,000	18.12%	Yes
M	(4,600)	27.78%	Yes
N	(9,000)	54.35%	Yes
O	12,000	72.46%	Yes
Total	2,960		

Hence, L, M, N, O are reportable segments.

(d) Calculation of Honey Ltd.'s investment in Smart Ltd. under equity method:

	₹	₹
Cost of investment		
Share in book value of net assets of Smart Limited (40% x 1,80,00,000)	72,00,000	
Share in fair valuation of net assets of Smart Limited (40% of (2,20,00,000-1,80,00,000)	16,00,000	

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Goodwill on Investment in Smart Limited (95,00,000-72,00,000-16,00,000) (Balancing Figure)	7,00,000	95,00,000
Profit during the year		
Share in the profit reported by Smart Ltd. (40% of ₹ 16,00,000)	6,40,000	
Adjustment to reflect effect of fair valuation [40% of (₹ 40,00,000/10 years)]	(1,60,000)	
Share of profit in Smart Ltd. recognised in income by Honey Ltd.		4,80,000
Long term equity investment		
FVTOCI gain recognised in OCI (40% of ₹ 4,00,000)		1,60,000
Dividend received by Honey Ltd. during the year [40% of ₹ 24,00,000]		(9,60,000)
Closing balance of Honey Ltd.'s investment in Smart Ltd.		91,80,000

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PAPER – 2 : STRATEGIC FINANCIAL MANAGEMENT

*Question No.**1** is compulsory.*

*Candidates are also required to answer any **four** from the remaining **five** questions.*

Working notes should form part of the respective answer.

Question 1

(a) *Alfa Ltd. wants to acquire Beta Ltd. and has offered a swap ratio of 1 : 2 (0.5 shares for every one share of Beta Ltd.). Following information is provided:*

	Alfa Ltd.	Beta Ltd.
Profit after tax (₹)	18,00,000	3,60,000
Equity shares outstanding (Nos.)	6,00,000	1,80,000
EPS (₹)	3	2
PE Ratio	10 times	7 times
Market price per share (₹)	30	14

(i) *You are required to determine:*

(a) *the number of equity shares to be issued by Alfa Ltd. for acquisition of Beta Ltd.*

(b) *the EPS of Alfa Ltd. after the acquisition.*

(c) *the equivalent earnings per share of Beta Ltd.*

(d) *the expected market price per share of Alfa Ltd.* after the acquisition, if PE increases to 12 times.*

(e) *the market value of the merged firm.*

(ii) *If you are the shareholder of Beta Ltd and holding 100 shares, will you be interested to sell your stake ? Why?* ***(8 Marks)***

** Mistakenly got typed as A Ltd.*

(b) *Mantra Ltd. is planning to buy Alay Ltd. Following information is given in respect of Alay Ltd. which is expected to grow at a rate of 18% p.a. for the next three years, after which the growth rate will stabilize at 8% p.a. normal level, in perpetuity:*

Particulars	For the year ended March 31, 2022
Revenues	₹ 6,800 Crores
Cost Of Goods Sold (COGS)	₹ 2,800 Crores
Operating Expenses	₹ 2,100 Crores
Capital Expenditure	₹ 750 Crores
Depreciation (included in Operating Exp.)	₹ 600 Crores

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During high growth period, Revenues & Earnings Before Interest & Tax (EBIT) will grow at 18% p.a. and capital expenditure net of depreciation will grow at 12% p.a. From 4th year onwards, i.e. normal growth period revenues and EBIT will grow at 8% p.a. and incremental capital expenditure will be offset by the depreciation. During both high growth & normal growth period, net working capital requirement will be 25% of revenues.

Corporate Income Tax rate is 30%.

The Weighted Average Cost of Capital (WACC) for both the companies is 15%.

You are required to estimate the value of Alay Ltd. using Free Cash Flows to Firm (FCFF) & WACC methodology.

The PVIF for the three years are as below:

Year	*t1*	*t2*	*t3*
PVIF @ 15%	*0.870*	*0.756*	*0.658*

(8 Marks)

(c) Briefly explain Asset and Liability Management (ALM). ***(4 Marks)***

Answer

(a) (i) (a) The number of shares to be issued by Alfa Ltd.:

The Exchange ratio is 0.5

So, new Shares = 1,80,000 x 0.5 = 90,000 shares.

(b) EPS of Alfa Ltd. after acquisition:

Total Earnings	(₹ 18,00,000 + ₹ 3,60,000)	₹ 21,60,000
No. of Shares	(6,00,000 + 90,000)	6,90,000
EPS	(₹ 21,60,000)/6,90,000)	₹ 3.13

(c) Equivalent EPS of Beta Ltd.:

No. of new Shares	0.5
EPS	₹ 3.13
Equivalent EPS (₹ 3.13 x 0.5)	₹ 1.57 or ₹ 1.56

(d) New Market Price of Alfa Ltd. (P/E = 12):

Revised P/E Ratio of Alfa Ltd.	12 times
Expected EPS after merger	₹ 3.13
Expected Market Price (₹ 3.13 x 12)	₹ 37.56

(e) Market Value of merged firm:

Total number of Shares	6,90,000

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	Expected Market Price	₹ 37.56
	Total value (6,90,000 x 37.56)	₹ 2,59,16,400
(ii)	Present market Value of share of Beta Ltd. (100 x ₹ 14)	₹ 1,400
	Revised market price of each share of Alfa Ltd. after Merger	₹ 37.56
	Equivalent No. of Alfa Ltd. share in exchange of Beta Ltd. (0.50 x 100)	50
	Equivalent Value of Alfa Ltd. share in exchange of Beta Ltd. (100x 0.50 x ₹ 37.56)	₹ 1,878
	Increase in Market Value (₹ 1,878 - ₹ 1,400)	₹ 478

No, I am not agreed to sell the stake as there is increase in market value.

(b) Determination of forecasted Free Cash Flow of the Firm (FCFF) (₹ in crores)

	Yr. 1	Yr. 2	Yr. 3	Terminal Year
Revenue	8,024.00	9,468.32	11,172.62	12,066.43
COGS	3,304.00	3,898.72	4,600.49	4,968.53
Operating Expenses* (*Excluding Depreciation)	1,770.00	2,088.60	2,464.55	2,661.71
Depreciation	708.00	835.44	985.82	1,064.68
EBIT	2,242.00	2,645.56	3,121.76	3,371.51
Tax @30%	672.60	793.67	936.53	1,011.45
EAT	1,569.40	1,851.89	2,185.23	2,360.06
Capital Exp. – Dep.	168.00	188.16	210.74	-----
∆ Working Capital	306.00	361.08	426.07	223.45
Free Cash Flow (FCF)	1,095.40	1,302.65	1,548.42	2,136.61

Terminal value is:

$$\frac{2136.61}{0.15-0.08} = ₹\ 30{,}523 \text{ Crore}$$

Present Value (PV) of FCFF:

FCFF (₹ in crores)	PVF @ 15%	PV (₹ in crores)
1,095.40	0.870	953.00
1,302.65	0.756	984.80
1,548.42	0.658	1,018.86
30,523	0.658	20,084.13
		23,040.79

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The value of the firm is ₹ 23,040.79 Crores

Note: The answer may vary due to rounding off difference.

(c) Asset-Liability Management (ALM) is one of the important tools of risk management in commercial banks of India. Indian banking industry is exposed to a number of risks prevailing in the market such as market risk, financial risk, interest rate risk etc. The net income of the banks is very sensitive to these factors or risks.

ALM is a comprehensive and dynamic framework for measuring, monitoring and managing the market risk of a bank. It is the management of structure of Balance Sheet (liabilities and assets) in such a way that the net earnings from interest are maximized within the overall risk preference (present and future) of the institutions. The ALM functions extend to liquidly risk management, management of market risk, trading risk management, funding and capital planning and profit planning and growth projection.

Banks and other financial institutions provide services which expose them to various kinds of risks like credit risk, interest risk, and liquidity risk. Asset liability management is an approach that provides institutions with protection that makes such risk acceptable. Asset-liability management models enable institutions to measure and monitor risk, and provide suitable strategies for their management.

It is therefore appropriate for institutions (banks, finance companies, leasing companies, insurance companies, and others) to focus on asset-liability management when they face financial risks of different types. Asset-liability management includes not only a formalization of this understanding, but also a way to quantify and manage these risks.

In a sense, the various aspects of balance sheet management deal with planning as well as direction and control of the levels, changes and mixes of assets, liabilities, and capital.

Question 2

(a) MNO Ltd., a company based in India, manufactures very high quality modern furniture and sells them to a small number of retail outlets in India and Nepal. It is facing tough competition. Recent studies on marketability of product have clearly indicated that the customers are now more interested in variety and choice rather than exclusivity and exceptional quality. Since the cost of quality wood in India is very high, the company is reviewing the proposal for import of wood in bulk from Nepalese supplier.

The estimate of net India (₹) and Nepalese Currency (NC) cash flow in nominal terms for this proposal is shown below:

Years	Net cash flow (in Millions)	
	NC	India (₹)
0	—38	0
1	1.8	1.9
2	3.2	3.5
3	4.1	4.4

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4	*5.4*	*5.8*
5	*6.5*	*6.9*

The following information is relevant :

(1) MNO Ltd. evaluates all investment by using a discount rate of 11% p.a. All Nepalese customers are invoiced in NC. NC cash flows are converted to Indian ₹ at the forward rate and discounted at the Indian rate.

(2) Inflation rate in Nepal and India are expected to be 11% and 10% p.a. respectively.

(3) The current exchange rate is ₹ 1 = NC 1.65

You are required to calculate Net Present value of the proposal. ***(8 Marks)***

(b) The following 2-way quotes appear in the foreign exchange market:

	Spot	*2-months spread*
₹/US $	*74.00/74.25*	*1.00/1.25*

(i) You are required to calculate:

(a) 2 months forward rates.

(b) How many US dollars should the firm sell to get ₹ 10 lakhs in the spot market and after 2 months?

(c) How many Rupees is the firm required to pay to obtain US $ 80,000 in the spot market and after 2 months?

(ii) Assume the firm has US $ 27,600 in current account earning no interest. ROI on Rupee investment is 10% p.a. Should the firm encash the US $ now or after 2 months? ***(8 Marks)***

(c) Explain various methods of hedging of interest rate risk. ***(4 Marks)***

Answer

(a) Working Notes:

(i) Computation of Forward Rates

End of Year	NC	NC/₹
1	NC 1.65 x $\left(\frac{(1+0.11)}{(1+0.10)}\right)$	1.665
2	NC 1.665 x $\left(\frac{(1+0.11)}{(1+0.10)}\right)$	1.680
3	NC 1.680 x $\left(\frac{(1+0.11)}{(1+0.10)}\right)$	1.695

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4	NC 1.695 x $\left(\frac{(1+0.11)}{(1+0.10)}\right)$	1.710
5	NC 1.710 x $\left(\frac{(1+0.11)}{(1+0.10)}\right)$	1.726

(ii) NC Cash Flows converted in Indian Rupees

Year	NC (Million)	Conversion Rate	₹ (Million)
0	-38.00	1.650	-23.03
1	1.80	1.665	1.081
2	3.20	1.680	1.905
3	4.10	1.695	2.419
4	5.40	1.710	3.158
5	6.50	1.726	3.766

Net Present Value

Year	Cash Flow in India	Cash Flow in Nepal	Total Cash Flow	PVF @ 11%	PV
0	---	-23.030	-23.030	1.000	-23.030
1	1.900	1.081	2.981	0.901	2.686
2	3.500	1.905	5.405	0.812	4.389
3	4.400	2.419	6.819	0.731	4.985
4	5.800	3.158	8.958	0.659	5.903
5	6.900	3.766	10.666	0.593	6.325
					1.258

(b) (i) (a) Two Month Forward Rates:

Buying Rate ₹ 74.00 + ₹ 1.00 = ₹ 75.00

Selling Rate ₹ 74.25 + ₹ 1.25 = ₹ 75.50

(b) (1) To get ₹ 10 lakh at Spot Market the firm should sell

= ₹ 10,00,000/ ₹ 74.00 = US $ 13,513.51

(2) To get ₹ 10 lakh after 2 month the firm should sell

= ₹ 10,00,000/ ₹ 75.00 = US $ 13,333.33

(c) (1) Rupees required to obtain US $ 80,000 in Spot Market:

US $ 80,000 × ₹ 74.25 = ₹ 59,40,000

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(2) Rupees required to obtain US $ 80,000 after 2 months:

US $ 80,000 × ₹ 75.50 = ₹ 60,40,000

(ii) If US$ are converted in ₹ now and get invested in India, then fund position after 2 months will be as follows:

US$ 27,600 × ₹ 74.00	₹ 20,42,400
ROI @ 10% p.a. for 2 month	₹ 34,040
Amount after 2 months	₹ 20,76,440

If US$ are converted after 2 month, then fund position will be:

$ 27,600 × ₹ 75.00 = ₹ 20,70,000

Thus, it is better to get converted US$ into ₹ now and get them invested in India.

Alternatively, this sub part can also be answered as follows:

Computation of Annual Premium on US $ = (1.00/74.00) × (12/2) × 100 = 8.108% or 8.11%

Since, the premium on US $ in lesser than ROI on Indian ₹, it is better to convert US $ in Indian ₹ now and get them invested in India.

(c) Methods of Hedging of Interest Rate Risk can be broadly divided into following two categories:

(A) Traditional Methods: These methods can further be classified in following categories:

(i) **Asset and Liability Management (ALM):** ALM is a comprehensive and dynamic framework for measuring, monitoring and managing the market risk of a bank. It is the management of structure of Balance Sheet (liabilities and assets) in such a way that the net earnings from interest are maximized within the overall risk preference (present and future) of the institutions.

(ii) **Forward Rate Agreement (FRA):** Normally it is used by banks to fix interest costs on anticipated future deposits or interest revenues on variable-rate loans indexed to Benchmark Interest Rate e.g. LIBOR, MIBOR etc. A bank that sells an FRA agrees to pay the buyer the increased interest cost on some "notional" principal amount if Reference Rate of some specified maturity is above a stipulated "Forward Interest Rate" on the contract maturity or settlement date. Conversely, the buyer agrees to pay the seller any decrease in interest cost if Reference Rate fall below the forward rate.

(B) Modern Methods: These methods can further be classified in following categories:

(i) **Interest Rate Futures (IRF):** An interest rate future is a contract between the

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buyer and seller agreeing to the future delivery of any interest-bearing asset. The interest rate future allows the buyer and seller to lock in the price of the interest-bearing asset for a future date.

(ii) **Interest Rate Options (IRO):** Also known as Interest Rate Guarantee (IRG) as option is a right not an obligation and acts as insurance by allowing businesses to protect themselves against adverse interest rate movements while allowing them to benefit from favourable movements.

It should be noted that the IRO is basically a series of FRAs which are exercisable at predetermined bench marked interest rates on each period say 3 months, 6 months etc.

(iii) **Interest Rate Swaps:** In an interest rate swap, the parties to the agreement, termed the swap counterparties, agree to exchange payments indexed to two different interest rates. Total payments are determined by the specified notional principal amount of the swap, which is never actually exchanged.

(iv) **Swaptions:** An interest rate swaption is simply an option on an interest rate swap. It gives the holder the right but not the obligation to enter into an interest rate swap at a specific date in the future, at a particular fixed rate and for a specified term.

Question 3

(a) Details about long term portfolio of shares of an investor is as below:

Shares	*No. of shares (Lakh)*	*Market Price per share*	*Beta*
K Ltd.	*6*	*250*	*1.4*
L Ltd.	*8*	*375*	*1.2*
M Ltd.	*4*	*125*	*1.6*

The investor thinks that the risk of portfolio is very high and wants to reduce the portfolio beta to 0.91.

He is considering below mentioned alternative strategies:

(i) Dispose a part of his existing portfolio to acquire risk free securities, or

(ii) Take appropriate position on Nifty Futures which are currently traded at 16250 and each Nifty points is worth ₹100.

You are required to determine:

(i) portfolio beta,

(ii) the value of risk-free securities to be acquired,

(iii) the number of shares of each company to be disposed off,

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(iv) the number of Nifty contracts to be bought/sold,

(v) the value of portfolio beta for 1% rise in Nifty. **(8 Marks)**

(b) Ms. Sreenidhi is learning the portfolio management techniques and wants to test one of the techniques she has developed on KIFS Equity Fund and compare the gains and losses from the technique with those from a passive buy and hold strategy.

The KIFS Equity Fund consists of equities only and the ending NAVs of the fund she constructed for the last 10 months are given below:

Month Ending	NAV (₹/unit)
Jan-22	100
Feb-22	78
Mar-22	92
Apr-22	86
May-22	102
Jun-22	98
Jul-22	100
Aug-22	102
Sep-22	118
Oct-22	120

Assume

(i) Sreenidhi had invested a notional amount of ₹ 5 lakhs equally in the equity fund and a conservative portfolio (of bonds) in the beginning of January 2022 and the total portfolio was being rebalanced each time the NAV of the fund increased or decreased by 15% compared to the NAV of previous month.

(ii) There is no income earned from the conservative portfolio during the period.

(iii) There is no taxation and entry/exit loads.

You are required to determine:

(i) Value of the portfolio for each level of NAV following the Constant Ratio Plan.

(ii) Whether there are any errors in the technique developed by Sreenidhi? If so briefly explain. **(8 Marks)**

(c) Write a short note on Money Market Hedging. **(4 Marks)**

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Answer

(a)

Shares	No. of shares (lakhs) (1)	Market Price of Per Share (2)	(1)× (2) (₹ lakhs)	% to total (w)	ß (x)	w*x
K Ltd.	6.00	250.00	1,500.00	0.30	1.40	0.42
L Ltd.	8.00	375.00	3,000.00	0.60	1.20	0.72
M Ltd.	4.00	125.00	500.00	0.10	1.60	0.16
			5,000.00	1.00		1.30

(i) Portfolio beta 1.30

(ii) Required Beta 0.91

Let the proportion of risk free securities for target beta 0.91 = p

0.91 = 0 × p + 1.30 (1 – p)

p = 0.30 i.e. 30%

Shares to be disposed off to reduce beta (5000 × 30%) ₹ 1,500 lakh and Risk Free securities to be acquired.

(iii) Number of shares of each company to be disposed off

Shares	% to total (w)	Proportionate Amount (₹ lakhs) (a)	Market Price Per Share (b)	No. of Shares to be disposed off (Lakh) (a/b)
K Ltd.	0.30	450.00	250.00	1.80
L Ltd.	0.60	900.00	375.00	2.40
M Ltd.	0.10	150.00	125.00	1.20

(iv) Number of Nifty Contract to be sold

$$\frac{(1.30 - 0.91) \times 5000 \text{ lakh}}{16{,}250 \times 100} = 120 \text{ contracts}$$

(v) 1% rises in Nifty is accompanied by 1% x 1.30 i.e. 1.30% rise for portfolio of shares

	₹ Lakh
Current Value of Portfolio of Shares	5,000
Value of Portfolio after rise	5,065
Mark-to-Market Margin paid (16250 × 0.01 × ₹ 100 × 120)	19.50
Value of the portfolio after rise of Nifty	5,045.50

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% change in value of portfolio (5,045.50 – 5,000)/ 5,000	0.91%
% rise in the value of Nifty	1%
Beta	0.91

(b) (i) Constant Ratio Plan:

Stock Portfolio NAV (₹)	Value of Conservative Portfolio (₹)	Value of aggressive Portfolio (₹)	Total value of Constant Ratio Plan (₹)	Revaluation Action	Total No. of units in aggressive portfolio
100	2,50,000.00	2,50,000.00	5,00,000.00	-	2500
78	2,50,000.00	1,95,000.00	4,45,000.00	-	2500
	2,22,500.00	2,22,500.00	4,45,000.00	Buy 352.56 units	2852.56
92	2,22,500.00	2,62,435.52	4,84,935.52	-	2852.56
	2,42,467.76	2,42,467.76	4,84,935.52	Sell 217.04 units	2635.52
86	2,42,467.76	2,26,654.72	4,69,122.48	-	2635.52
102	2,42,467.76	2,68,823.04	5,11,290.80	-	2635.52
	2,55,645.40	2,55,646.40	5,11,290.80	Sell 129.19 units	2506.33
98	2,55,645.40	2,45,620.34	5,01,265.74	-	2506.33
100	2,55,645.40	2,50,633.00	5,06,278.40	-	2506.33
102	2,55,645.40	2,55,645.66	5,11,291.06	-	2506.33
118	2,55,645.40	2,95,746.94	5,51,392.34	-	2506.33
	2,75,696.17	2,75,696.17	5,51,392.34	Sell 169.92 units	2336.41
120	2,75,696.17	2,80,369.20	5,56,065.37	-	2336.41

Hence, the ending value of the mechanical strategy is **₹ 5,56,065.37** and buy & hold strategy is (₹2,50,000+ 2,500 X ₹120 = ₹5,50,000)

(ii) Though the value of portfolio as per technique is lesser than Buy & Hold Strategy but there is no error as if market has been bearish then the value of much lesser under Buy & Hold Strategy.

(c) At its simplest, a money market hedge is an agreement to exchange a certain amount of one currency for a fixed amount of another currency, at a particular date. For example, suppose a business owner in India expects to receive 1 Million USD in six months. This Owner could create an agreement now (today) to exchange 1Million USD for INR at roughly the current exchange rate. Thus, if the USD dropped in value by the time the

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business owner got the payment, he would still be able to exchange the payment for the original quantity of U.S. dollars specified.

Advantages of Money Market Hedging

(i) Fixes the future rate, thus eliminating downside risk exposure.

(ii) Flexibility with regard to the amount to be covered.

(iii) Money market hedges may be feasible as a way of hedging for currencies where forward contracts are not available.

Disadvantages of Money Market Hedging

(i) More complicated to organize than a forward contract.

(ii) Fixes the future rate - no opportunity to benefit from favorable movements in exchange rates.

Question 4

(a) Following is the information related to three mutual funds:

Year	*MF-A*	*MF-B*	*MF-C*
2020	*10%*	*5%*	*14%*
2021	*8%*	*10%*	*10%*
2022	*12%*	*8%*	*18%*

Correlation between market and mutual fund:

	MF-A	*MF-B*	*MF-C*
Correlation with market	*0.45*	*0.25*	*0.65*

Variance of the market is 9% and rate of return of government bond is 7%.

You are required to Rank the Mutual fund using Sharpe's ratio and Treynor's ratio.

(8 Marks)

(b) M/s. Siri Ltd. Has a surplus amount of ₹ 3 crores to invest and has shortlisted the following equity shares:

Company	*Beta*
S Ltd.	*1.6*
K Ltd.	*1*
P Ltd.	*-0.3*
D Ltd.	*2*
C Ltd.	*0.6*

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Required:

(i) If M/s. Siri Ltd. invests an equal amount in all securities, what is the beta of the portfolio?

(ii) If M/s. Siri Ltd. invests 15% of its investment in S Ltd., 15% in P Ltd., 10% in C Ltd. and the balance in equal amount in the other two securities, what is the beta of the portfolio?

(iii) If the expected return of market portfolio is 12% at a beta factor of 1.0, what will be the portfolios expected return in both the situations given above?

(iv) If the Company changes its policy to invest in any 3 securities with a minimum of 20% in each of these 3 securities to diversify risk, you are requested to advise the company to have a right mix of securities to maximize the return in the following two scenarios and also calculate the expected return:

(1) Bull Phase: Expected Market returns 10%

(2) Bear Phase: Expected Market returns — 5% ***(8 Marks)***

(c) What are the features of Securitization? ***(4 Marks)***

Answer

(a) (i) Calculation of Standard Deviation of Funds

Year	MF-A (%)	Dev.	Dev.^{2}	MF-B (%)	Dev.	Dev.^{2}	MF-C (%)	Dev.	Dev.^{2}
2020	10	-	-	5	-2.67	7.13	14	-	-
2021	8	-2	4	10	2.33	5.43	10	-4	16
2022	12	2	4	8	0.33	0.11	18	4	16
	30		8	23		12.67	42		32
	Avg. = 30/3 = 10		Var. = 8/3 = 2.67 σ_A = 1.63	Avg. = 23/3 = 7.67		Var. 12.67/3 = 4.22 σ_B = 2.05	Avg. = 42/3 = 14		Var. 32/3 = 10.67 σ_C = 3.27

(ii) Calculation of Beta of MFs

	r	σ_M	σi	Var. of Market	β_i
MF-A	0.45	3	1.63	9	0.244
MF-B	0.25	3	2.05	9	0.171
MF-C	0.65	3	3.27	9	0.709

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Reward to Variability (Sharpe Ratio)

Mutual Fund	R_p	R_f	$R_p - R_f$	σ_p	Reward to Variability	Ranking
MF-A	10.00	7.00	3.00	1.63	1.84	2
MF-B	7.67	7.00	0.67	2.05	0.33	3
MF-C	14.00	7.00	7.00	3.27	2.14	1

Reward to Volatility (Treynor Ratio)

Mutual Fund	R_p	R_f	$R_p - R_f$	β_p	Reward to Volatility	Ranking
MF-A	10.00	7.00	3.00	0.244	12.30	1
MF-B	7.67	7.00	0.67	0.171	3.92	3
MF-C	14.00	7.00	7.00	0.709	9.87	2

(b) (i) Beta of the Portfolio

Investment	Beta (β)	Investment (₹ Lakhs)	Weighted Investment
S Ltd.	1.6	60	96
K Ltd.	1.0	60	60
P Ltd.	-0.3	60	-18
D Ltd.	2.0	60	120
C Ltd.	0.6	60	36
		300	294

$$\beta_P = \frac{294 \text{ lakh}}{300 \text{lakh}} = 0.98$$

Alternatively, it can also be computed as follows:

$$1.6 \times \frac{1}{5} + 1.0 \times \frac{1}{5} + (-0.30) \times \frac{1}{5} + 2 \times \frac{1}{5} + 0.6 \times \frac{1}{5} = 0.98$$

(ii) With varied percentages of investments portfolio beta is calculated as follows:

Investment	Beta (β)	Investment (₹ Lakhs)	Weighted Investment
S Ltd.	1.6	45	72
K Ltd.	1.0	90	90
P Ltd.	-0.3	45	-13.50
D Ltd.	2.0	90	180

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C Ltd.	0.6	30	18
		300	346.50

$$\text{Beta} = \frac{346.50}{300} = 1.155$$

(iii) Expected return of the portfolio with pattern of investment as in case (i) = 12% × 0.98 i.e. 11.76%

Expected Return with pattern of investment as in case (ii) = 12% × 1.155 i.e., 13.86%.

(iv) (1) Securities to be selected during Bull Phase Expected Market returns 10%

As it is bull Market Higher Beta stocks should be selected.

Shares	% to be invested	Beta (β)	Investment	Weighted Investment
S Ltd.	20	1.6	60,00,000	96,00,000
K Ltd.	20	1	60,00,000	60,00,000
P Ltd.	0	-0.3	-	-
D Ltd.	60	2	1,80,00,000	3,60,00,000
C Ltd.	0	0.6	-	-
	100		3,00,00,000	5,16,00,000

Portfolio or Weighted Beta (β) (5,16,00,000/ 3,00,00,000)	1.72
Portfolio Beta (β)	1.72
Market Return	10%
Expected Return	17.20%

(2) Securities to be selected During Bear Phase Expected Market returns – 5%

As it is bear market Lower Beta stocks should be selected

Shares	% to be invested	Beta (β)	Investment	Weighted Investment
S Ltd.	0	1.6	-	-
K Ltd.	20	1	60,00,000	60,00,000
P Ltd.	60	-0.3	1,80,00,000	-54,00,000
D Ltd.	0	2	-	-
C Ltd.	20	0.6	60,00,000	36,00,000
	100		3,00,00,000	42,00,000

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Portfolio or Weighted Beta (β) (42,00,000/ 3,00,00,000)	0.14
Portfolio Beta (β)	0.14
Market Return	-5%
Expected Return	-0.70%

(c) The securitization has the following features:

(i) **Creation of Financial Instruments** – The process of securities can be viewed as process of creation of additional financial product of securities in market backed by collaterals.

(ii) **Bundling and Unbundling** – When all the assets are combined in one pool it is bundling and when these are broken into instruments of fixed denomination it is unbundling.

(iii) **Tool of Risk Management** – In case of assets are securitized on non-recourse basis, then securitization process acts as risk management as the risk of default is shifted.

(iv) **Structured Finance –** In the process of securitization, financial instruments are tailor structured to meet the risk return trade of profile of investor, and hence, these securitized instruments are considered as best examples of structured finance.

(v) **Trenching** – Portfolio of different receivable or loan or asset are split into several parts based on risk and return they carry called 'Tranche'. Each Trench carries a different level of risk and return.

(vi) **Homogeneity** – Under each tranche the securities issued are of homogenous nature and even meant for small investors who can afford to invest in small amounts.

Question 5

(a) Following is the information related to return on shares of three different companies :

Years	*A Ltd.*	*B Ltd.*	*C Ltd.*
2018	*2%*	*3%*	*5%*
2019	*6%*	*8%*	*7%*
2020	*13%*	*14%*	*15%*
2021	*7%*	*9%*	*11%*

Required:

(i) Construct maximum number of portfolio and its return, if each portfolio consists of any two Company's shares in proportion of 65% and 35% and suggest which portfolio provides highest return.

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(ii) *Calculate portfolio return and beta (β), if Mr. X invests ₹ 65,000 in A Ltd. having beta (β) of 0.45; ₹ 20,000 in B Ltd. having beta (β) of 1.15 and ₹ 15,000 in C Ltd. having beta (β) of 1.8.* ***(8 Marks)***

(b) *The following information was extracted from the books of M/s Murugan Ltd.:*

Face Value of Bond	*₹ 1000*
Coupon Interest Rate	*8.5%*
Time Period of Maturity Remaining	*4 Years*
Interest Payment	*Annual, at the end of the year*
Principal Repayment	*At the end of the Bond maturity*
Conversion Ratio (Number of shares per Bond)	*30*
Current Market Price per Share	*₹ 55*
Market Price of Convertible Bond	*₹ 1725*

It can issue plain bonds without conversion option at an Interest rate of 10.5%.

Year	t_1	t_2	t_3	t_4
PVIF@10.5%	*0.905*	*0.819*	*0.741*	*0.671*

Based on the above data, you are requested to calculate:

(i) *Straight value of bonds*

(ii) *Conversion Value of Bond*

(iii) *Conversion Premium*

(iv) *Percentage of Down Turn Risk*

(v) *Conversion Parity Price* ***(8 Marks)***

(c) *What do you mean by Bootstrapping? Explain the method of Trade Credit used by the startup firms in bootstrapping.* ***(4 Marks)***

Answer

(a) Calculation of Average Return

Year	A Ltd.	B Ltd.	C Ltd.
2018	2%	3%	5%
2019	6%	8%	7%
2020	13%	14%	15%
2021	7%	9%	11%
Sum	28%	34%	38%
Average	7%	8.50%	9.50%

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(i) (1) Combination 1 - 65% in A Ltd. & 35% B Ltd.

Return = 7% × 0.65 + 8.50% × 0.35 = 4.55% + 2.975% = 7.525% or 7.53%

(2) Combination 2 – 65% in B Ltd. & 35% in C Ltd.

Return = 8.50% × 0.65 + 9.50% × 0.35 = 5.525% + 3.325% = 8.85%

(3) Combination 3 – 65% in C Ltd. & 35% in A Ltd.

Return = 0.65 × 9.50% + 0.35 × 7.00% = 6.175% + 2.45% = 8.625% or 8.63%

(4) Combination 4 – 65% in A Ltd. & 35% in C Ltd.

Return = 0.65 × 7% + 0.35 × 9.50% = 4.55% + 3.325% = 7.875% or 7.88%

(5) Combination 5 – 35% in A Ltd. & 65% in B Ltd.

Return = 0.35 × 7% + 0.65 × 8.50% = 2.45% + 5.525% = 7.975% or 7.98%

(6) Combination 6 – 35% in B Ltd. & 65% in C Ltd.

Return = 0.35 × 8.50% + 0.65 × 9.50% = 2.975% + 6.175% = 9.15%

Since maximum return is under Combination - 6 i.e. 65% investment in C Ltd. and 35% in B Ltd. hence it should be opted for.

(ii) Calculation of Return and Beta of Portfolio

$$\text{Return of Portfolio} = 7\% \times \frac{65,000}{1,00,000} + 8.50\% \times \frac{20,000}{1,00,000} + 9.50\% \times \frac{15,000}{1,00,000}$$

= 7.675%

$$\text{Beta of Portfolio} = 0.45 \times \frac{65,000}{1,00,000} + 1.15 \times \frac{20,000}{1,00,000} + 1.80 \times \frac{15,000}{1,00,000} =$$

0.7925 or 0.79

(b) (i) Straight Value of Bond

= ₹ 85 x 0.905 + ₹ 85 x 0.819 + ₹ 85 x 0.741 + ₹ 1085 x 0.671

= ₹ 76.93 + ₹ 69.62 + ₹ 62.99 + ₹ 728.04 = ₹ 937.56

(ii) Conversion rate is 30 shares per bond. Market price of share ₹ 55

Conversion Value 30 x ₹ 55 = ₹ 1,650

(iii) Conversion Premium

$$\frac{\text{Market Price} - \text{Conversion Value}}{\text{Conversion Value}} \times 100$$

$$\frac{₹1725 - ₹\ 1650}{₹\ 1650} \times 100 = 4.55\%$$

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Alternatively, it can also be computed on Per Share/ Bond basis as follows:

$$\frac{₹\ 1725 - ₹\ 1650}{₹\ 30} = ₹\ 2.50 \text{ Per Share or } ₹\ 1725 - ₹\ 55 \times 30 = ₹\ 75$$

(iv) $$\frac{₹\ 1725 - ₹\ 937.50}{₹\ 937.50} \times 100 = 0.84 \text{ or } 84\%$$

or $$\frac{₹\ 1725 - ₹\ 937.50}{₹\ 1725} \times 100 = 0.4565 \text{ or } 45.65\%$$

This ratio gives the percentage price decline experienced by the bond if the stock becomes worthless.

(v) Conversion Parity Price

$$\frac{\text{Bond Price}}{\text{No. of Shares on Conversion}}$$

$$\frac{₹\ 1725}{30} = ₹\ 57.50$$

(c) An individual is said to be boot strapping when he or she attempts to found and build a company from personal finances or from the operating revenues of the new company.

Trade Credit - When a person is starting his business, suppliers are reluctant to give trade credit. They will insist on payment of their goods supplied either by cash or by credit card. However, a way out in this situation is to prepare a well-crafted financial plan. The next step is to pay a visit to the supplier's office. If the business organization is small, the owner can be directly contacted. On the other hand, if it is a big firm, the Chief Financial Officer can be contacted and convinced about the financial plan.

Communication skills are important here. The financial plan has to be shown. The owner or the financial officer has to be explained about the business and the need to get the first order on credit in order to launch the venture. The owner or financial officer may give half the order on credit and balance on delivery. The trick here is to get the goods shipped and sell them before paying to them. One can also borrow to pay for the good sold but there is interest cost also. So trade credit is one of the most important way to reduce the amount of working capital one needs. This is especially true in retail operations.

Question 6

(a) Mr. X wants to invest ₹ 1,00,000 in the 7 years 8% bonds in the market (Face Value ₹ 100) which were issued 2 years ago.

(i) You are requested to advise him what is the maximum price for bonds to be paid in the following scenarios:

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(1) If Mr. X is expecting minimum 9% return on the bonds

(2) If Mr. X is expecting minimum 7% return on the bonds

(3) If the present rate of similar bonds issued is 8.25%

(4) If the present rate of similar bonds issued is 7.75%

(ii) If the bonds are available at par and 1% is the transaction cost, what is the effective yield?

(iii) Find the number of days required to breakeven transaction cost if the bonds are available at par and 2% is the transaction cost. ***(8 Marks)***

(b) (i) What is sustainable growth rate?.

(ii) What makes an Organization Sustainable?

(iii) Mr. X has submitted the following data:

Particulars	***(₹) in Lakhs***
Total Assets	*250*
Total Liabilities	*220*
Net Income	*12*
Dividend Paid	*4.5*
Sales	*100*

Mr. X wants to know to what extent sales can be increased without going for additional borrowings by using Sustainable Growth Rate (SGR) concept? ***(8 Marks)***

(c) Write a short note on Venture Capital Fund.

OR

What are the applications of Value At Risk (VAR) ? ***(4 Marks)***

Answer

(a) (i) The maximum price to be paid for Bond

(1) To have a return of 9% return on Bond.

$$= ₹\ 100 \times \frac{8}{9} = ₹\ 88.89$$

Alternative Answer

$$= \frac{8}{(1.09)^1} + \frac{8}{(1.09)^2} + \frac{8}{(1.09)^3} + \frac{8}{(1.09)^4} + \frac{108}{(1.09)^5}$$

= ₹ 7.34 + ₹ 6.73 + ₹ 6.18 + ₹ 5.67 + ₹70.19 = ₹ 96.11

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(2) To have a return of 7% return on Bond.

$= ₹\ 100 \times \frac{8}{7} = ₹\ 114.29$

Alternative Answer

$= \frac{8}{(1.07)^1} + \frac{8}{(1.07)^2} + \frac{8}{(1.07)^3} + \frac{8}{(1.07)^4} + \frac{108}{(1.07)^5}$

= ₹ 7.48 + ₹ 6.99 + ₹ 6.53 + ₹ 6.10 + ₹ 77.00 = ₹ 104.10

(3) If present rate of similar bond issued is 8.25%

$= \frac{8}{(1.0825)^1} + \frac{8}{(1.0825)^2} + \frac{8}{(1.0825)^3} + \frac{8}{(1.0825)^4} + \frac{108}{(1.0825)^5}$

= ₹ 7.39 + ₹ 6.83 + ₹ 6.31 + ₹ 5.83 + ₹ 72.66 = ₹ 99.02

Alternative Answer

$= ₹\ 100 \times \frac{8}{8.25} = ₹\ 96.97$

(4) If present rate of similar bond issued is 7.75%

$= \frac{8}{(1.0775)^1} + \frac{8}{(1.0775)^2} + \frac{8}{(1.0775)^3} + \frac{8}{(1.0775)^4} + \frac{108}{(1.0775)^5}$

= ₹ 7.42 + ₹ 6.89 + ₹ 6.39 + ₹ 5.94 + ₹ 74.36

= ₹ 101.00

Alternative Answer

$= ₹\ 100 \times \frac{8}{7.75} = ₹\ 103.23$

(ii) Effective yield if transaction cost is 1% $= \frac{8}{101} \times 100 = 7.92$

(iii) No. of Days required for break even

$= \frac{2\% \times 1{,}00{,}000}{1{,}00{,}000 \times \frac{8\%}{360}} = \frac{2{,}000}{22.22} = 90$ days

Alternatively, if 365 days used in Calculation then answer will be as follows:

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$$= \frac{2\% \times 1,00,000}{1,00,000 \times \frac{8\%}{365}} = \frac{2,000}{21.92} = 91.24 \text{ days say } 91 \text{ days}$$

(b) (i) The sustainable growth rate is a measure of how much a firm can grow without borrowing more money. After the firm has passed this rate, it must borrow funds from another source to facilitate growth.

(ii) In order to be sustainable, an organisation must:

- have a clear strategic direction;
- be able to scan its environment or context to identify opportunities for its work;
- be able to attract, manage and retain competent staff;
- have an adequate administrative and financial infrastructure;
- be able to demonstrate its effectiveness and impact in order to leverage further resources; and
- get community support for, and involvement in its work.

(iii)

Sl. No	Particulars	Amount in ₹ Lakhs
(a)	Total Assets	250.00
(b)	Total Liabilities	220.00
(c)	Net Income	12.00
(d)	Dividend Paid	4.50
(e)	Sales	100.00
(f)	Equity (a) – (b)	30.00
(g)	Return on Equity (ROE) (c) /(f)	40.00%
(h)	Dividend pay-out Ratio (d) /(c)	37.50%
(i)	SGR [g x (1-h)]	25.00%*
(j)	Additional Sales can be achieved without further borrowings (e) × (i)	25.00
(k)	Maximum sales can be achieved without further borrowings (e) + (j)	125.00

* Alternatively, it can also be computed as follows:

SGR = $\frac{g(1-h)}{1-[g(1-h)]}$ = 33.33% and then Additional Sales shall be ₹ 33.33 Lakhs and Maximum Sales can be achieved without further borrowings shall be ₹ 133.33 Lakhs

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(c) Venture Capital Fund means investment vehicle that manage funds of investors seeking to invest in startup firms and small businesses with exceptional growth potential. Venture capital is money provided by professionals who alongside management invest in young, rapidly growing companies that have the potential to develop into significant economic contributors.

Venture Capitalists generally

- Finance new and rapidly growing companies
- Purchase equity securities
- Assist in the development of new products or services
- Add value to the company through active participation.

OR

VAR can be applied

a. to measure the maximum possible loss on any portfolio or a trading position.

b. as a benchmark for performance measurement of any operation or trading.

c. to fix limits for individuals dealing in front office of a treasury department.

d. to enable the management to decide the trading strategies.

e. as a tool for Asset and Liability Management especially in banks.

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PAPER – 3 : ADVANCED AUDITING AND PROFESSIONAL ETHICS

*Question No. **1** is compulsory*

*Answer any **four** out of remaining five*

Question 1

(a) *AP & Associates, Chartered Accountants, are Statutory Auditors of XP Limited for the last four years. XP Limited is engaged in the manufacture and marketing of FMCG Goods in India. During 2021-22, the Company has diversified and commenced providing software solutions in the area of "e-commerce" in India as well as in certain European countries. AP & Associates, while carrying out the audit for the current financial year, came to know that the company has expanded its operations into a new segment as well as new geography. AP & Associates does not possess necessary expertise and infrastructure to carry out the audit of this diversified business activities and accordingly wishes to withdraw from the engagement and client relationship. Discuss the issues that need to be addressed before deciding to withdraw.* ***(5 Marks)***

(b) *During the audit of Star Ltd. a company engaged in the production of paper, the auditor received certain confirmation for the balances of trade payables outstanding in the balance sheet through external confirmation by "Negative Confirmation Request". In the list of trade payables, there are number of small balances except one which is an old outstanding of ₹ 20 lakhs for which no confirmation was received. Comment with respect to Standards of Auditing relating to the confirmation process and how to deal the non-receipt of confirmation.* ***(5 Marks)***

(c) *TP Ltd. a government company engaged in providing tourism services, has failed to get its accounts audited by Statutory Auditor for the financial year 2021-22. You have been appointed as Tax Auditor for the same period and management provided the unaudited financial statements which have been adopted in the Annual General Meeting. Subsequently, the Statutory Auditor while auditing observed that there is a material misstatement in providing depreciation on fixed assets due to which financial statements have been revised. Now the company is requesting you to revise the tax audit report. You are required to state whether Tax Audit Report can be revised and if so, under what circumstances?* ***(4 Marks)***

Answer

(a) Acceptance and Continuance of Client Relationships and Specific Engagements: As per SQC 1, "Quality Control for Firms that Perform Audit and Reviews of Historical Financial Information, and other Assurance and Related Services Engagements", the firm should establish policies and procedures for the acceptance and continuance of client relationships and specific engagements, designed to provide it with reasonable assurance that it will undertake or continue relationships and engagements only where it is competent to perform the engagement and has the capabilities, time and resources to do so.

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In the given case, AP & Associates, Chartered Accountants, statutory auditors of XP Limited for the last four years, came to know that the company has expanded its operations into a new segment as well as new geography. AP & Associates does not possess necessary expertise for the same, therefore, AP & Associates wish to withdraw from the engagement and client relationship. Policies and procedures on withdrawal from an engagement or from both the engagement and the client relationship **address issues that include the following:**

- Discussing with the appropriate level of the client's management and those charged with its governance regarding the appropriate action that the firm might take based on the relevant facts and circumstances.
- If the firm determines that it is appropriate to withdraw, discussing with the appropriate level of the client's management and those charged with its governance withdrawal from the engagement or from both the engagement and the client relationship, and the reasons for the withdrawal.
- Considering whether there is a professional, regulatory or legal requirement for the firm to remain in place, or for the firm to report the withdrawal from the engagement, or from both the engagement and the client relationship, together with the reasons for the withdrawal, to regulatory authorities.
- Documenting significant issues, consultations, conclusions and the basis for the conclusions.

AP & Associates should address the above issues before deciding to withdraw.

(b) **External Confirmation:** As per SA 505, "External Confirmation", negative confirmation is a request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request. Negative confirmations provide less persuasive audit evidence than positive confirmations.

The failure to receive a response to a negative confirmation request does not explicitly indicate receipt by the intended confirming party of the confirmation request or verification of the accuracy of the information contained in the request.

Accordingly, a failure of a confirming party to respond to a negative confirmation request provides significantly less persuasive audit evidence than does a response to a positive confirmation request.

Confirming parties also may be more likely to respond indicating their disagreement with a confirmation request when the information in the request is not in their favour, and less likely to respond otherwise.

In the instant case, the auditor sent the negative confirmation requesting the trade payables having outstanding balances in the balance sheet while doing audit of Star Limited. One of the old outstanding of ₹ 20 lakh has not sent the confirmation on the credit balance. In case of non-response, the auditor may examine subsequent cash

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disbursements or correspondence from third parties, and other records, such as goods received notes. Further non-response for negative confirmation request does not means that there is some misstatement as negative confirmation request itself is to respond to the auditor only if the confirming party disagrees with the information provided in the request.

(c) Revision of Tax Audit Report: The CBDT has, vide this notification, amended Rule 6G to provide that the audit report furnished may be revised by the person by getting revised report of audit from a chartered accountant, duly signed and verified by such chartered accountant, if there is payment by such person after furnishing of report which necessitates recalculation of disallowance under section 40 or section 43B. The said revised audit report has to be furnished before the end of the relevant assessment year for which the report pertains.

Further, when the accounts are revised in the following circumstances, the tax auditor may have to revise his tax audit report also.

(i) Revision of accounts of a company after its adoption in the annual general meeting.

(ii) Change in law with retrospective effect.

(iii) Change in interpretation of law (e.g.) CBDT Circular, Notifications, Judgments, etc.

The Tax Auditor should state it is a revised report, clearly specifying the reasons for such revision with a reference to the earlier report.

In the given case of TP Ltd., a government company failed to get its accounts audited by statutory auditor therefore, unaudited financial statements were provided for tax audit by the management which have been adopted in AGM. However, it was observed during statutory audit that there was a material misstatement in providing depreciation on fixed assets, accordingly, financial statements have been revised.

In view of above, tax auditor is required to revise his tax audit report as it is revision of accounts of a company after its adoption in the annual general meeting.

Question 2

(a) CA. B was appointed as the auditor of SRT Limited for the financial year 2021-22. During the course of planning for the audit, CA. B intends to apply the concept of materiality for the financial statements as a whole. Please guide him with respect to the factors that may affect the identification of an appropriate benchmark for this purpose.

What benchmark should be adopted by CA. B, if SRT Limited is engaged in:

(i) the manufacture and sale of air conditioners and is having regular profits.

(ii) the construction of large infrastructure projects and incurred losses in the previous two financial years, due to pandemic. ***(5 Marks)***

(b) ABC Limited holds 51% equity of BBB Limited, 63% equity of TTT Limited. There are different information and explanations which are disclosed by the respective companies in the notes to their financial statements. At the time of consolidation, management of ABC

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Limited has consolidated all the information and explanations disclosed in the notes as well. The principal auditor is of the view that only those information and explanations should form part of the notes to the consolidated financial statements which are relevant at group level. Please mention any five aspects which are given in the notes to the separate financial statements of the parent and the subsidiaries, need not be included in the consolidated financial statements. ***(5 Marks)***

(c) *You have been requested to carry out a forensic audit of a listed entity by the Board of Directors, based on a whistle blower complaint received. Before the commencement of the forensic audit, you and your team, are discussing the various aspects relating to the scope and the procedures to be carried out. What would be the items of discussion with respect to the differences between forensic audit and other audit?* ***(4 Marks)***

Answer

(a) Use of Benchmarks in Determining Materiality for the Financial Statements as a Whole: As per SA 320, determining materiality involves the exercise of professional judgment. A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole.

Factors that may affect the identification of an appropriate benchmark include the following:

- The elements of the financial statements (for example, assets, liabilities, equity, revenue, expenses);
- Whether there are items on which the attention of the users of the particular entity's financial statements tends to be focused (for example, for the purpose of evaluating financial performance users may tend to focus on profit, revenue or net assets);
- The nature of the entity, where the entity is at in its life cycle, and the industry and economic environment in which the entity operates;
- The entity's ownership structure and the way it is financed (for example, if an entity is financed solely by debt rather than equity, users may put more emphasis on assets, and claims on them, than on the entity's earnings); and
- The relative volatility of the benchmark.

Determining a percentage to be applied to a chosen benchmark involves the exercise of professional judgment. There is a relationship between the percentage and the chosen benchmark, such that a percentage applied to profit before tax from continuing operations will normally be higher than a percentage applied to total revenue.

In case if SRT Limited is engaged in manufacture and sale of air conditioner, and is having regular profits: CA. B, the auditor may consider profit before tax /Earnings.

In case if SRT Limited is engaged in the construction of large infrastructure projects and incurred losses in the previous two financial years, due to pandemic: CA. B, the auditor may consider Revenue or Gross Profit as benchmarking. Alternatively, CA B, the auditor

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may consider the criteria relevant for audit of the entities doing public utility programs/ projects, Total cost or net cost (expenses less revenues or expenditure less receipts) may be appropriate benchmarks for that particular program/project activity. Where an entity has custody of the assets, assets may be an appropriate benchmark.

(b) The Ind AS 110 does not give a list of information which is part of the separate financial statement of the components but that need not be reported in the notes and other explanatory material of the consolidated financial statements, however, based on section 129(4) and circular issued by MCA, it can be construed that, even in consolidated financial statements under Ind AS, only those disclosures should be given which are relevant to consolidated financial statements.

Based on the above discussion, in case of companies, the information such as the following given in the notes to the separate financial statements of the parent and/or the subsidiary, need not be included in the consolidated financial statements.

(i) Source from which bonus shares are issued, e.g., capitalization of profits or reserves or from securities premium account.

(ii) Disclosure of all unutilized monies out of the issue indicating the form in which such unutilized funds have been invested.

(iii) Disclosure required under Micro, Small and Medium Enterprises Development Act, 2006.

(iv) A statement of investments (whether shown under "financial assets or non-financial assets as stock-in-trade) separately classifying trade investments and other investments, showing the names of the bodies corporate (indicating separately the names of the bodies corporate under the same management) in whose shares or debentures, investments have been made (including all investments, whether existing or not, made subsequent to the date as at which the previous balance sheet was made out) and the nature and extent of the investment so made in each such body corporate.

(v) Value of imports calculated on C.I.F. basis by the company during the financial year in respect of:

(a) raw materials;

(b) components and spare parts;

(c) capital goods.

(vi) Expenditure in foreign currency during the financial year on account of royalty, know-how, professional and consultation fees, interest, and other matters.

(vii) Value of all imported raw materials, spare parts and components consumed during the financial year and the value of all indigenous raw materials, spare parts and components similarly consumed and the percentage of each to the total consumption.

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(viii) The amount remitted during the year in foreign currencies on account of dividends, with a specific mention of the number of non-resident shareholders, the number of shares held by them on which the dividends were due and the year to which the dividends related.

(ix) Earnings in foreign exchange classified under the following heads, namely:

(a) export of goods calculated on F.O.B. basis;

(b) royalty, know-how, professional and consultation fees;

(c) interest and dividend;

(d) other income, indicating the nature thereof.

(c) Difference between forensic audit and other audit is as under:

Sr. No.	Particulars	Other Audits	Forensic Audit
1.	Objectives	Express an opinion as to 'True & Fair' presentation	Whether fraud has actually taken place in books
2.	Techniques	Substantive & Compliance. Sample based	Investigative, substantive or in-depth checking
3.	Period	Normally for a particulars accounting period.	No such limitations
4.	Verification of stock, Estimation realizable value of assets, provisions, liability etc.	Relies on the management certificate/Management Representation	Independent/verification of suspected/selected items where misappropriation in suspected
5.	Off balance sheet items (like contracts etc.)	Used to vouch the arithmetic accuracy & compliance with procedures.	Regulatory & propriety of these transactions/contracts are examined.
6.	Adverse findings if any	Negative opinion or qualified opinion expressed with/without quantification	Legal determination of fraud impact and identification of perpetrators depending on scope.

Question 3

(a) ABC Ltd. is engaged in the business of trading and manufacturing of readymade garments. The company has large balances of accounts receivables as on March 31, 2022, which has been assessed as the area of high risk in the audit planning stage. For the year ended March 31, 2022, in respect of the valuation of accounts receivables, the Statutory Auditor

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has assigned the checking of the accuracy of the ageing of the accounts receivables and provision made towards doubtful receivables, to the internal auditor. Please advise the statutory auditor, the areas in which direct assistance from internal auditor cannot be taken. Also, comment in this scenario, whether statutory auditor can take internal auditor's assistance. ***(5 Marks)***

(b) *CA. M is commencing the Statutory Audit of a limited company, which is engaged in trading software products and providing software solutions. CA. M was evaluating the controls environment and noted that the established internal controls are functioning in an automated environment. Enumerate any five focal points for the consideration of CA. M, when auditing in the automated environment, with respect to his audit approach during planning, execution and completion phases.* ***(5 Marks)***

(c) *Mt. P, a Chartered Accountant did not maintain books of account for his professional work on the ground that his income is assessed under Section 44ADA of the Income Tax Act, 1961. Comment with reference to the Chartered Accountants Act, 1949 and Schedules thereto.* ***(4 Marks)***

Answer

(a) Direct Assistance from Internal Auditor: As per SA 610 "Using the Work of Internal Auditor", the external auditor shall not use internal auditors to provide direct assistance to perform procedures that:

(i) Involve making significant judgments in the audit;

(ii) Relate to higher assessed risks of material misstatement where the judgment required in performing the relevant audit procedures or evaluating the audit evidence gathered is more than limited;

(iii) Relate to work with which the internal auditors have been involved and which has already been, or will be, reported to management or those charged with governance by the internal audit function; or

(iv) Relate to decisions the external auditor makes in accordance with this SA regarding the internal audit function and the use of its work or direct assistance.

Therefore, the amount of judgment involved, and the risk of material misstatement are also relevant in determining the work that may be assigned to internal auditors providing direct assistance.

In the given situation of ABC Ltd., in circumstances where the valuation of accounts receivable is assessed as an area of higher risk, the external auditor could assign the checking of the accuracy of the aging to an internal auditor providing direct assistance.

However, because the evaluation of the adequacy of the provision based on the aging would involve more than limited judgment, it would not be appropriate to assign that latter procedure to an internal auditor providing direct assistance.

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(b) In a controls-based audit in an automated environment, the audit approach can be classified into three broad phases comprising of planning, execution, and completion. In this approach, the considerations of automated environment will be relevant at every phase as given below:

Planning Phase:

- during risk assessment, the auditor should consider risk arising from the use of IT systems at the company;
- when obtaining an understanding of the business process and performing walkthroughs the use of IT systems and applications should be considered;

Execution Phase:

- while assessing the entity level controls the aspects related to IT governance need to be understood and reviewed;
- pervasive controls including segregation of duties, general IT controls and applications should be considered and reviewed;
- during testing phase, the results of general IT controls would impact the nature, timing and extent of testing;
- when testing of reports and information produced by the entity (IPE) generated through IT systems and applications;

Completion Phase:

- at completion stage, evaluation of control deficiencies may require using data analytics and CAATs.

(c) **Maintenance of Books of Account:** As per the Council General Guidelines 2008, under Chapter 5 on maintenance of books of accounts, it is specified that if a chartered accountant in practice or the firm of Chartered Accountants of which he is a partner fails to maintain and keep in respect of his/its professional practice, proper books of account including the Cash Book and Ledger, he is deemed to be guilty of professional misconduct.

Accordingly, it does not matter whether section 44ADA of the Income Tax Act, 1961 applies or not.

Conclusion: Hence, Mr. P is guilty of professional misconduct.

Question 4

(a) You have been appointed as an Auditor of LOC Bank, a nationalized bank. LOC Bank also deals in providing credit card facilities to its account holders. The bank is aware of the fact that there should be strict control over the storage and issuance of credit cards. How will you evaluate the internal control system in the area of credit card operations of the Bank?

(5 Marks)

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(b) *The professional accountants need to observe certain fundamental principles, which are covered in the Code of Ethics of the Institute of Chartered Accountants of India. Briefly explain each of the five principles which needs to be complied by the Chartered Accountants?* ***(5 Marks)***

(c) *While evaluating the risks and control at the entity level, the Auditor should take cognizance of the prevalent direct and indirect entity level control operating in the entity. Explain, what are such controls with few examples.* ***(4 Marks)***

Answer

(a) Credit Card Operations System of Internal Control in Banks: The auditor should evaluate the internal control in the area of credit card operations of LOC Bank as under:

- There should be effective screening of applications with reasonably good credit assessments.
- There should be strict control over storage and issue of cards.
- There should be a system whereby a merchant confirms the status of unutilized limit of a credit-card holder from the bank before accepting the settlement, in case the amount to be settled exceeds a specified percentage of the total limit of the card holder.
- There should be a system of prompt reporting by the merchants of all settlements accepted by them through credit cards.
- Reimbursement to merchants should be made only after verification of the validity of merchant's acceptance of cards.
- All the reimbursement (gross of commission) should be immediately charged to the customer's account.
- There should be a system to ensure that statements are sent regularly and promptly to the customer.
- There should be a system to monitor and follow-up customers' payments.
- Payments overdue beyond a reasonable period should be identified and attended to carefully. For defaulting customers, credit should be stopped by informing the merchants through periodic bulletins, as early as possible, to avoid increased losses.
- There should be a system of periodic review of credit card holders' accounts. On this basis, the limits of customers may be revised, if necessary. The review should also include determination of doubtful amounts and the provisioning in respect thereof.

(b) Fundamental Principles: In order to achieve the objectives of the Accountancy profession, professional accountants have to observe a number of prerequisites or fundamental principles. The fundamental principles as discussed in Code of Ethics of ICAI, to be complied, are given below:

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(i) **Integrity –** A professional accountant shall comply with the principle of integrity, **which requires an accountant to be straightforward and honest** in all professional and business relationships. Integrity implies fair dealing and truthfulness.

(ii) **Objectivity –** A professional accountant shall comply with the principle of objectivity, which requires an accountant not to compromise professional or business judgment because of bias, conflict of interest or undue influence of others.

(iii) **Professional Competence and Due Care – A professional accountant shall comply with the principle of professional competence and due care,** which requires an accountant to:

(a) Attain and maintain professional knowledge and skill at the level required to ensure that a client or employing organization receives competent professional service, based on current technical and professional standards and relevant legislation; and

(b) act diligently in accordance with applicable technical and professional standards.

(iv) **Confidentiality –** A professional accountant shall comply with the principle of confidentiality, which requires an accountant to respect the confidentiality of information acquired as a result of professional and employment relationships.

(v) **Professional Behaviour –** A professional accountant shall comply with the principle of professional behaviour, which requires an accountant to comply with relevant laws and regulations and avoid any conduct that accountant knows or should know might discredit the profession.

Conduct that might discredit the profession includes conduct that a reasonable and informed third party would be likely to conclude adversely affects the good reputation of the profession.

A professional accountant shall not knowingly engage in any employment, occupation or activity that impairs or might impair the integrity, objectivity or good reputation of the profession, and as a result would be incompatible with the fundamental principles.

(c) Entity Level Controls: There are direct entity level controls and indirect entity level controls.

(i) **Direct ELCs** operate at a level higher than business activity or transaction level such as a business process or sub-process level, account balance level, at a sufficient level of precision, to prevent, detect or correct a misstatement in a timely manner.

Examples include:

- Business performance reviews;
- Monitoring of effectiveness of controls activities by Internal Audit function;

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(ii) Indirect ELCs do not relate to any specific business process, transaction or account balance and hence, cannot prevent or detect misstatements. However, they contribute indirectly to the effective operation of direct ELC and other control activities.

Examples include:

- Company code of conduct and ethics policies;
- Human resource policies;
- Employee job roles & responsibilities.

Question 5

(a) CA. Uma is the Statutory Auditor of RJ Ltd. for the financial year 2021-22. The company is engaged in the production of electronic products. During the course of audit, CA. Uma obtained certain audit evidence of incorrect disclosure of related party transactions and structured finance deals which was not considered with the affirmation leading to misstatement in the financial statements. Discuss how CA Uma should deal with the situation in the auditor's report and the different options which can be considered?

(5 Marks)

(b) You are appointed as the Auditor of XMP Pvt. Ltd. for financial year 2021-22 after the resignation of RS & Co. Chartered Accountants, as statutory auditor of the company. RS & Co., had certain concerns on the accounting matters of the company, leading to change of auditors. All the compliances under Sections 139 and 140 are made by the company with regard to resignation and appointment.

During the course of audit, it came to your notice that a survey has been conducted on December 7, 2021 by the Income Tax Department and department has unearthed unrecorded sales of ₹ 5 lakhs which had been made in cash on different dates during the year 2020-21. XMP Pvt. Ltd. has purchased gold from such collections and these transactions are not recorded. Company surrendered and disclosed these transactions before the assessing officer and paid taxes thereon. However, company has not recorded those transactions in books of account even after surrender before Income Tax authorities.

You want to report the above matters in CARO, but the management requested you not to report them. Comment with respect to auditor's response to the management and his reporting requirements to the shareholders. ***(5 Marks)***

(c) NR Ltd., a leading manufacturer of kids garments has decided to acquire TP Ltd. TP Ltd. is currently engaged in the manufacture of ladies garments. NR Ltd, entrusted you to carry out the due diligence and value TP Ltd. The valuation of TP Ltd. is dependent on future maintainable sales of the company. Discuss the factors that you would consider in assessing the future maintainable sales of TP Ltd. ***(4 Marks)***

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Answer

(a) Auditor's duties in case of inconsistency in Audit evidence: SA 705 "Modifications to the Opinion in the Independent Auditor's Report", deals with auditor's responsibility to issue an appropriate report in circumstances when, in forming an opinion in accordance with SA 700 (Revised), the auditor concludes that a modification to the auditor's opinion on the financial statements is necessary.

The decision regarding which type of modified opinion is appropriate depends upon:

(a) The nature of the matter giving rise to the modification, that is, whether the financial statements are materially misstated or, in the case of an inability to obtain sufficient appropriate audit evidence, may be materially misstated; and

(b) The auditor's judgement about the pervasiveness of the effects or possible effects of the matter on the financial statements.

Further, the auditor shall modify the opinion in the auditor's report when the auditor concludes that based on the audit evidence obtained, that the financial statements as a whole are not free from material misstatement:

In the present case, during the course of the audit, CA Uma obtained certain audit evidence which was not consistent with the affirmation made in financial statements. Therefore CA Uma should modify his report in accordance with SA 705.

Conclusion:

Since CA Uma has obtained audit evidence which is inconsistent with the affirmations made in the financial statements. CA Uma should modify his opinion as per the circumstances of the case.

- CA Uma shall express Qualified opinion when, having obtained sufficient appropriate audit evidence, he concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements.
- CA Uma shall express an Adverse opinion, where the auditor, having obtained sufficient appropriate evidence, concludes that misstatements, individually, or in the aggregate, are both material and pervasive to the financial statements.

(b) Clause (xviii) of Paragraph 3 of CARO, 2020:

In the given situation of XMP Pvt Ltd, the auditors RS & Co. resigned due to concerns on the accounting matters of the company. However, all the compliances regarding resignation and appointments discussed in section 139 and 140 of the Companies Act, 2013 are also being complied with. The auditor would be required to report the same in CARO, 2020 as per Clause (xviii) of Paragraph 3 of CARO, 2020 given hereunder:

Clause (xviii) of Paragraph 3 of CARO, 2020 requires the auditor to report whether there has been any resignation of the statutory auditors during the year, if so, whether the auditor has taken into consideration the issues, objections or concerns raised by the outgoing auditors.

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Clause (viii) of Paragraph 3 of CARO, 2020:

Further, the auditors noticed that a survey was conducted by the Income Tax Department and unrecorded sales of Rs 5 Lakhs were unearthed which had been made in cash on different dates during the year. XMP Pvt Ltd. has also purchased gold and the transactions remained unrecorded. Though Company surrendered and disclosed these transactions before the Assessing Officer and paid taxes thereon. The auditor would be required to report in CARO as per Clause (viii) of Paragraph 3 of CARO, 2020.

Clause (viii) of Paragraph 3 of CARO, 2020 requires the auditor to report -whether any transactions not recorded in the books of account have been surrendered or disclosed as income during the year in the tax assessments under the Income Tax Act, 1961 (43 of 1961), if so, whether the previously unrecorded income has been properly recorded in the books of account during the year.

Since it is a statutory obligation on the part of the auditor to report in terms of CARO, 2020 as given above and consequently management's request to the auditor that not to report the above transactions is not tenable.

(c) In assessing the turnover which the business would be able to maintain in the future, the following factors should be taken into account:

(i) **Trend:** Whether in the past, sales have been increasing consistently or they have been fluctuating. A proper study of this phenomenon should be made.

(ii) **Marketability:** Is it possible to extend the sales into new markets or that these have been fully exploited? Product wise estimation should be made.

(iii) **Political and economic considerations:** Are the policies pursued by the Government likely to promote the extension of the market for goods to other countries? Whether the sales in the home market are likely to increase or decrease as a result of various emerging economic trends?

(iv) **Competition:** What is the likely effect on the business if other manufacturers enter the same field or if products which would sell in competition are placed on the market at cheaper price? Is the demand for competing products increasing? Is the company's share in the total trade constant or has it been fluctuating?

Question 6

(a) What is a Core Investment Company (CIC) under the Reserve Bank of India regulations? What are the specific reporting requirements to be considered by an auditor in respect of CIC under CARO 2020? ***(5 Marks)***

(b) AB & Co., Chartered Accountants, is a large firm based in Mumbai. AB & Co. is subject to peer review. For the peer review of the financial year ended March 31, 2021 the firm got an intimation on June 30, 2021. X & Co., Chartered Accountants, were appointed to undertake the peer review process. Upon completion of the peer review, X & Co., observed certain non-compliance with auditing standards. X & Co., did not share any of observations

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with AB & Co. and submitted its final report to the Peer Review Board of the Institute of Chartered Accountants. Comment. ***(5 Marks)***

(c) *CA. Raj is the auditor of a multiplex cinema house. He has observed during the course of the audit, that the existing venue has undergone renovation. The auditorium was split into smaller ones and additional auditoriums were constructed. CA. Raj, who finalised the audit plan and audit programme wanted to reconsider the same during the course of the audit. Discuss a few circumstances where the audit programme would have to be suitably altered by the auditor.*

OR

Mr. X is a practising Chartered Accountant. Mr. Y is a practising advocate representing matters in the court of law. X and Y decided to help each other in matters involving their professional expertise. Accordingly, Mr. X recommends Mr. Y in all litigation matters in the court of law and Y consults X in all matters relating to finance and other related matters, which come to him in arguing various cases, consequently, they started sharing profits of their professional work. Is Mr. X liable for professional misconduct? ***(4 Marks)***

Answer

(a) **Core Investment Companies:** As per RBI Master Direction – Core Investment Companies (Reserve Bank) Directions, 2016, (Reference may be made to aforesaid Master Direction), these directions shall apply to every Core Investment Company (CIC), that is to say, a non-banking financial company carrying on the business of acquisition of shares and securities and which satisfies the following conditions as on the date of the last audited balance sheet:-

(i) it holds not less than 90% of its net assets in the form of investment in equity shares, preference shares, bonds, debentures, debt or loans in group companies;

(ii) its investments in the equity shares (including instruments compulsorily convertible into equity shares within a period not exceeding 10 years from the date of issue) in group companies and units of Infrastructure Investment Trust only as sponsor constitute not less than 60% of its net assets as mentioned in clause (i) above;

Provided; that the exposure of such CICs towards InvITs shall be limited to their holdings as sponsors and shall not, at any point in time, exceed the minimum holding of units and tenor prescribed in this regard by SEBI (Infrastructure Investment Trusts) Regulations, 2014, as amended from time to time.

(iii) it does not trade in its investments in shares, bonds, debentures, debt or loans in group companies except through block sale for the purpose of dilution or disinvestment;

(iv) it does not carry on any other financial activity referred to in Section 45I(c) and 45I(f) of the Reserve Bank of India Act, 1934 except

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a. investment in

(i) bank deposits,

(ii) money market instruments, including money market mutual funds and liquid mutual funds

(iii) government securities, and

(iv) bonds or debentures issued by group companies,

b. granting of loans to group companies and

c. Issuing guarantees on behalf of group companies.

As per CARO 2020, the auditor is required to report that –

(i) Whether the company is a Core Investment Company (CIC) as defined in the regulations made by the Reserve Bank of India, if so, whether it continues to fulfil the criteria of a CIC, and in case the company is an exempted or unregistered CIC, whether it continues to fulfil such criteria; [Paragraph 3(xvi) (c)]

(ii) Whether the Group has more than one CIC as part of the Group, if yes, indicate the number of CICs which are part of the Group; [Paragraph 3(xvi) (d)]

(b) (i) After completing the on-site Review, the Peer Reviewer, before making his Report to the Board, shall communicate his findings in the Preliminary Report to the Practice Unit if in his opinion, the systems and procedures are deficient or non-compliant with reference to any matter that has been noticed by him or if there are other matters where he wants to seek clarification.

(ii) The Practice Unit shall within 5 days after the date of receipt of the findings, make any submissions or representations, in writing to the Reviewer. (i.e. Response to the Preliminary Report).

(iii) At the end of an on-site Review if the Reviewer is satisfied with the reply received from the Practice Unit, he shall submit a Peer Review Report to the Board along with his initial findings, response by the Practice Unit and the manner in which the responses have been dealt with. A copy of the report shall also be forwarded to the Practice Unit.

(iv) In case the Reviewer is of the opinion that the response by the Practice Unit is not satisfactory, the Reviewer shall accordingly submit a modified Report to the Board incorporating his reasons for the same. The Reviewer shall also submit initial findings (i.e. Preliminary Report), response by the Practice Unit (Response to Preliminary Report) and the manner in which the responses have been dealt with. A copy of the report shall also be forwarded to the Practice Unit.

(v) In case of a modified report, The Board shall order for a "Follow On" Review after a period of one year from the date of issue of report as mentioned above. If the Board

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so decides, the period of one year may be reduced but shall not be less than six months from the date of issue of the report.

Conclusion: In the instant case, in view of X & Co. Peer Reviewer, systems and procedures in AB & Co. are deficient; therefore, Peer Reviewer should not submit the report directly to the Board.

Alternative Answer:

Eligibility to be a Reviewer: As per Peer Review Statement,

1. A Peer Reviewer shall: -
   (a) Shall be a member in practice with at least 7 years of audit experience.
   (b) In case a member has moved from industry to practice and is currently in practice he should have at least 10 years of audit experience in industry and at least 3 years audit experience in practice.
   (c) Should have undergone the requisite training and cleared the requisite test for Peer Review as prescribed by the Board.
2. A member on being appointed as a Reviewer shall be required to furnish-
   (a) a declaration as prescribed by the Board, at the time of Empanelment as a Peer Reviewer.
   (b) a Declaration of Confidentiality as per Annexure A to this Statement while giving consent for appointment as a Peer Reviewer.
3. A member shall not be eligible for being appointed as a Reviewer of a Practice Unit, if -
   (i) any disciplinary action / proceeding is pending against him;
   (ii) he has been found guilty of professional or other misconduct by the Council or the Board of Discipline or the Disciplinary Committee at any time
   (iii) he has been convicted by a competent court whether within or outside India, of an offence involving moral turpitude and punishable with imprisonment,
   (iv) he or his partners have any obligation or conflict of interest in the Practice Unit.
   (v) He has undergone training/articleship under any of the partner of Practice Unit.
4. A Reviewer shall not accept any professional assignment from the Practice Unit for a period of next two years from the date of appointment. Further, he should not have accepted any professional assignment from the Practice Unit for a period of two years before the date of appointment as reviewer of that Practice Unit.

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In the current scenario, X & Co., Chartered Accountants, were appointed to undertake the peer review process. X & Co. is a firm not an individual member a. Hence, as per the above eligibility criteria, only an individual can be appointed as a peer reviewer and not a firm. Therefore, appointment of X & Co. as Peer Reviewer is not in order.

(c) In the given case of multiplex cinema house, CA Raj observed that existing venue undergone renovation, being split into smaller ones and additional auditoriums were constructed. Since CA Raj developed the audit program keeping in view a multiplex cinema house but during the audit, circumstances have changed significantly and hence CA Raj should suitably alter the audit program.

Given below are a few circumstances where in the audit programme would have to be suitably altered:

(1) If the audit procedures were designed for a certain volume of turnover and subsequently the volume have substantially increased. Also, when there have been significant changes in the accounting organisation, procedures and personnel subsequent to the audit procedures.

(2) Where during the course of an audit, it has been discovered that internal control procedures were not as effective as assumed at the time the audit programme was framed.

(3) Where there has been an extraordinary increase in the amount of book debts or that in the value of stocks as compared to that in the previous year.

(4) When a suspicion has aroused during the course of audit or information has been received that assets of the company have been misappropriated.

It may be noted that the audit plan and related programme should be reconsidered as the audit progresses. Such re-consideration is based on the auditor's review of internal control, his preliminary evaluation thereof and the result of his compliance and substantive procedures.

Or

(c) According to Clause (2) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he pays or allows or agrees to pay or allow, directly or indirectly, any share, commission or brokerage in the fees or profits of his professional business, to any person other than a member of the Institute or a partner or a retired partner or the legal representative of a deceased partner, or a member of any other professional body or with such other persons having such qualifications as may be prescribed, for the purpose of rendering such professional services from time to time in or outside India.

Furthermore, Clause (3) of Part I of the First Schedule to the said Act states that a

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Chartered Accountant in practice is deemed to be guilty of professional misconduct if he accepts or agrees to accept any part of the profits of the professional work of a person who is not a member of the Institute.

However, a practicing member of the Institute can share fees or profits arising out of his professional business with such members of other professional bodies or with such other persons having such qualifications as prescribed by the Council under Regulation 53-A of the Chartered Accountants Regulations, 1988. Under the said regulation, the member of "Bar Council of India" (Advocate) is included.

Therefore, Mr. Y, a practicing advocate, a member of Bar Council, is allowed to share part of profits of his professional work with Mr. X. Hence, Mr. X, a practicing Chartered Accountant, will not be held guilty under any of the above-mentioned clauses for paying and accepting part of profits to/from Mr. Y.

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PAPER- 4 – CORPORATE AND ECONOMIC LAWS

*Question No. **1** is compulsory.*

*Answer any **four** out of the remaining **five** questions*

Question 1

(a) *TY Limited has borrowed a sum of ₹25,00,000 from its director Mr. Tanmay. The company fails to obtain prior approval of Audit Committee constituted under the provisions of Section 177 of the Companies Act, 2013 (the Act). Auditors of the company expressed the view that the approval of Audit Committee was mandatory being a related party transaction. However, the Company Secretary submitted his comment that since this transaction is not covered under the related party transaction as per Section 188 of the Act, approval of Audit Committee was not required and hence, the company has not committed any violation of the provisions of the Act. Referring to the provisions of the Companies Act, 2013, examine:*

(i) *Whether omnibus approval of Audit Committee was needed to the borrowings, if the transaction was not a related party transaction under Section 188 of the Act?*

(ii) *Can a post transaction approval of Audit Committee be obtained for related party transaction and if not done so, what will be the effect on the transaction?* ***(4 Marks)***

(b) *APC Limited has held four board meetings during a period of twelve months. All board meetings were held at the registered office of the company situated in Chennai. Mr. Prakash, the non-executive, non-independent director, has not attended any board meeting in person but attended only one meeting through audio-video means.*

Mr. Akash was appointed as independent director of the company on 31st August, 2022 and as required, obtained the Director Identification Number (DIN) immediately on the next day and attended all board meetings held after his appointment. Referring to the provisions of the Companies Act, 2013 examine the following issues arising out of the above scenarios:

(i) *Vacation of office of director of Mr. Prakash, if he has not attended any board meeting in person.*

(ii) *Validity of attending the board meetings by Mr. Akash in his capacity of a director.*

(4 Marks)

(c) *Mary Limited is a company listed on National Stock Exchange. The company's Articles empower the Board of Directors to appoint additional directors. Accordingly, the Board of directors appointed Mr. Kamlesh as an additional director. It may, however, be pointed out that earlier, the proposal to appoint Mr. Kamlesh as a director on the company's Board was rejected by the members of the company at an Annual General Meeting.*

Examining the provisions of the Companies Act, 2013, answer the following questions:

(i) *Whether Mr. Kamlesh's appointment as an additional director by the Board of director is valid?*

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(ii) Can members exercise the power of appointing Mr. Kamlesh as an additional director at the Annual General Meeting (AGM) when the proposal to appoint comes before the AGM for the first time?

(iii) In case the company's Annual General Meeting is not held within the stipulated time and adjourned to a later date, decide whether Mr. Kamlesh, who was appointed validly by the Board as additional director for the first time, can continue to act as a director.

(6 Marks)

Answer

(a) As per section 2(76) read with sections 177(4)(iv), 188 of the Companies Act, 2013, and Rule 6A of the Companies (Meetings of Board and its Powers) Rules, 2014 following shall be the answers:

(i) As per Rule 6A of the Companies (Meetings of Board and its Powers) Rules, 2014, all related party transactions shall require approval of the Audit Committee and the Audit Committee may make omnibus approval for related party transactions proposed to be entered into by the company subject to the certain conditions.

As per section 177(4)(iv), every Audit Committee shall act in accordance with the terms of reference specified in writing by the Board which shall, inter alia, include approval or any subsequent modification of transaction of the company with related parties.

Provided that the Audit Committee may make omnibus approval for related party transactions proposed to be entered into by the company subject to such conditions as may be prescribed.

Provided further that in case of transactions, other than transactions referred to in section 188 and where Audit Committee does not approve the transaction, it shall make its recommendations to the Board.

In the instant case, borrowings of sum of ₹ 25,00,000 from TY Limited from its director Mr. Tanmay reflects that they are related parties as per section 2(76) and the transaction is a related party transaction though the transaction i.e. borrowings of ₹ 25,00,000 between them is not Related Party Transaction as per section 188(1).

Hence, in the given case, said transaction of borrowings, was a Related Party Transaction other than the transaction given under Section 188(1).

Note: Students may also conclude answer stating "said transaction of borrowings, was not a Related Party Transaction as per section 188(1), so no omnibus approval of Audit Committee was needed to such the borrowings by TY Limited from its director Mr. Tanmay.

(ii) As per Rule 6A of the Companies (Meetings of Board and its Powers) Rules, 2014, all related party transactions shall require approval of the Audit Committee. Where

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the need for related party transaction cannot be foreseen and no information related to that are available, the audit committee may make omnibus approval for such transactions subject to their value not exceeding ₹ 1 Crore per transaction.

In case of a transaction which does not involve an amount exceeding one crore rupees and which is entered into by a director or officer of the company without obtaining the approval of the Audit Committee and if it is not ratified by the Audit Committee within three months from the date of the transaction, such transaction shall be voidable at the option of the Audit Committee.

In view of above, a post transaction approval of the Audit Committee can be obtained for related party transaction and if not done so, such transaction shall be voidable at the option of the Audit Committee.

Further, in case such transaction is with the related party to any director, the director concerned shall indemnify the company against any loss incurred by it.

(b) (i) According to section 167 (1) of the Companies Act, 2013, the office of a director shall become vacant in case he absents himself from all the meetings of the Board of Directors held during a period of 12 months with or without seeking leave of absence of the Board.

Also, Section 173(2) of the Act allows the directors of a company to attend Board meetings either in person, through video conferencing or other audio-visual means as prescribed under Rule 3 of the Companies (Meetings of Board and its Powers) Rules, 2014.

In the instant case, Mr. Prakash has attended only one meeting of APC Limited through audio- video means during a period of twelve months and has not attended any other board meeting in person.

Hence, taking into account the above provisions, the office of Mr. Prakash is not to be vacated even though he has not attended any Board Meeting in person, as he has attended one meeting through audio- video means.

(ii) As per section 152(3) of the Companies Act, 2013, a person shall be appointed as a director of a company only when he has been allotted DIN under section 154.

Further, as per section 164(1), a person shall not be eligible for appointment as a director of a company, if he has not complied with sub-section (3) of section 152.

In light of the above provisions, the appointment of Mr. Akash as an independent director is invalid as he obtained DIN after his appointment.

Hence, attending of board meetings by Mr. Akash is not valid.

(c) As per section 161(1) of the Companies Act, 2013, following legal aspects are to be taken into consideration for appointment of additional director:

(a) The articles of a company may confer on its Board of Directors the power to appoint

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any person as an additional director at any time.

(b) A person, who fails to get appointed as a director in a general meeting, cannot be appointed as an additional director.

(c) Additional director shall hold office up to the date of the next annual general meeting or the last date on which the annual general meeting should have been held, whichever is earlier.

Taking into account the above provisions:

(i) The appointment of Mr. Kamlesh as an additional director by the Board of Directors is not valid, as earlier the proposal to appoint Mr. Kamlesh as a director on the company's Board was rejected by the members of the company at an AGM.

(ii) No, the members cannot exercise the power of appointing Mr. Kamlesh as an additional director at the AGM as section 161(1) clearly specifies that the said power can be conferred by Articles of company only on the Board of Directors.

(iii) If company's AGM is not held within the stipulated time and adjourned to a later date, Mr. Kamlesh cannot continue to act as a director as he can hold the office upto the last date on which the AGM should have been held.

Question 2

(a) Mr. Sunil is the Legal Manger in Sonata Limited. Sonata Limited is under investigation for alleged falsification of accounts. During investigation, Mr. Sunil disclosed some confidential information to the investigating officer. Now the company wants to suspend Mr. Sunil from his services. What is the remedy available to Mr. Sunil? What procedure should be adopted by Sonata Limited to implement its decision to suspend Mr. Sunil? Explain with the provisions of the Companies Act, 2013. ***(4 Marks)***

(b) On direction of the National Company Law Tribunal a meeting is held to adopt the scheme of compromise between DTC Limited and its 10,000 creditors representing in value of ₹ 100 crore. The Chairman of the meeting declared the voting details, as below:

(1) Total votes casted in favour of the schemes:

In person	*2,000 creditors representing in value ₹ 35 crore*
By proxy	*1,000 creditors representing in value ₹ 15 crore*
By postal ballot	*2,000 creditors representing in value ₹ 20 crore*

(2) Total votes casted against the scheme:

In person	*3,000 creditors representing in value ₹ 5 crore*
By proxy	*1,000 creditors representing in value ₹ 15 crore*

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(3) Total 1,000 creditors representing in value ₹10 crore did not attend the meeting

Referring to the provisions of the Companies Act, 2013 analyse, whether the scheme of compromise has been adopted by the meeting and its binding effect on the dissenting and absent creditors. ***(4 Marks)***

(c) ADL Limited is eligible for External Commercial Borrowing (ECB). It raised ECB of INR 100 crore on 01.01.2021 from eligible foreign lender to establish a power plant in India. As the forest and other government clearances are getting delayed, the implementation of the project is likely to be deferred by one year. Hence, the company dropped down the ECB amount of INR 100 crore and parked the proceeds, as detailed below:

(i) INR 80 crore were parked in capital market, the break-up of which is that - INR 20 crore in equity shares, INR 40 crore in secured debentures and INR 20 crore in mutual funds.

(ii) INR 20 crore in term deposits with AD Category 1 bank in compliance with all conditions.

Referring to the provisions of the Foreign Exchange Management Act, 1999. examine the validity of the parking of ECB proceeds in the manner as detailed above. ***(3 Marks)***

(d) A Flying Club in Indore, India was established in the year 2016. The principal activity of the club is to impart classroom and field training to the aspiring pilots. After running smoothly for first five years the club became defunct. With the initiative and support of the Government it could be revived during the year 2021. To restart the training activity the club exported two aircraft engines and spare parts for repairs abroad and getting them back to India within six months for functioning of the club activities.

The club had with it one imported aircraft on lease basis which was also re-exported abroad permanently by cancelling the lease agreement and obtaining the requisite approvals / permissions of the government agencies. However, the club failed to furnish declaration to the Reserve Bank of India and other authorities with respect to this export. Referring to the provisions of the Foreign Exchange Management Act, 1999, analyse, whether the club has contravened the provisions of the Act relating to export and re-export of the said goods. ***(3 Marks)***

Answer

(a) The provision of section 218 of the Companies Act, 2013 states that, the company shall require to take approval of the Tribunal before taking action against the employee during the course of any investigation of the affairs.

The company shall require approval in the following circumstances:

- discharge or suspension of an employee; or
- punishment to an employee by dismissal, removal, reduction in rank or otherwise; or
- change in the terms of employment to the disadvantage of employee(s).

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The Tribunal shall notify its objection to the action proposed in writing.

In case, the company, other body corporate or person concerned does not receive the approval of the Tribunal within 30 days of making the application, it may proceed to take the action proposed against the employee. That means it can be considered as a deemed approval by the Tribunal.

Thus, Sonata Limited should adopt the above-mentioned procedure to implement its decision to suspend Mr. Sunil.

Remedy available to Mr. Sunil: Remedy to Mr. Sunil will be available only when objection has not been raised by the Tribunal to the action proposed in writing for his suspension of his services. As per the provision of the law, Mr. Sunil can refer an appeal to Appellate Tribunal only if an objection has not been raised by Tribunal within 30 days.

(b) As per section 230 (6) of the Companies Act, 2013 where majority of persons at a meeting held representing 3/4th in value, voting in person or by proxy or by postal ballot, agree to any compromise or arrangement and if such compromise or arrangement is sanctioned by the Tribunal by an order, the same shall be binding on the company, all the creditors or class of creditors or members or class of members, as the case may be.

The majority of person representing 3/4th Value shall be counted of the following:

- the creditors, or
- class of creditors or
- members or
- class of members, as the case may be,

The majority is dual, in number and in value. A simple majority of those voting is sufficient. Whereas the 'three-fourths' requirement relates to value. The three-fourths value is to be computed with reference to value of creditors held by creditors present and voting at the meeting.

In this case, 9000 creditors attended the meeting representing in value ₹ 90 Crore. As 5000 creditors voted in favor of the scheme, the requirement relating to majority in number (i.e. 4501) is satisfied.

9000 creditors who participated in the meeting representing in value ₹ 90 Crore, three-fourth of which works out to ₹ 67.50 Crore while 5000 creditors who voted for the scheme representing in value is ₹ 70 Crore. The majority representing three-fourths in value is also satisfied.

As both the requirements are fulfilled, the scheme is adopted and approved by the requisite majority and the same shall be binding on the company, all the creditors, or class of creditors or members or class of members, as the case may be.

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Thus, the scheme of compromise is binding on all the creditors including the dissenting and absent creditors.

(c) ECB proceeds are permitted to be parked abroad as well as domestically.

Parking of ECB proceeds domestically: ECB proceeds meant for Rupee expenditure should be repatriated immediately for credit to their Rupee accounts with AD Category I banks in India.

ECB borrowers are also allowed to park ECB proceeds in term deposits with AD Category I banks in India for a maximum period of 12 months cumulatively. These term deposits should be kept in unencumbered position.

By looking at the above provisions,

(i) Parking of ₹ 80 crore in capital market is not valid.

(ii) Parking of ₹ 20 crore in term deposit with AD category 1 bank in compliance with all condition is valid.

(d) Export of goods / software may be made without furnishing the declaration in the following cases, namely:

(i) aircrafts or aircraft engines and spare parts for overhauling and/or repairs abroad subject to their reimport into India after overhauling /repairs, within a period of six months from the date of their export;

(ii) re-export of leased aircraft/helicopter under cancellation of the lease agreement between the lessor and lessee subject to permission by DGCA/Ministry of Civil Aviation for such export/s.

In the instant case, since Flying Club has fulfilled the requirement with respect to export and re- export of goods in compliance with FEM (Export of Goods and Services) Regulations, 2015, hence, not furnishing of the declaration to the RBI and other authorities with respect to this export and re-export, is not the contravention from Flying Club.

Question 3

(a) Ganga Textiles Limited incurred huge losses during the last three financial years and its financial position was quite bad. The Company created a legal mortgage on some of its immovable properties in favour of a bank on August 21, 2021, in the hope that by keeping good faith with the bank, it could get further advances from the bank and the same could be utilized to revive the Company. Some creditors filed a winding-up petition in the Tribunal on January 15, 2022 and the Tribunal passed an order of winding-up on August 1, 2022.

Referring to the relevant provisions of the Companies Act, 2013, explain whether the creation of a legal mortgage by the company in favour of the bank will amount to fraudulent preference. ***(4 Marks)***

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(b) CNC Limited is a foreign company having its places of business in Mumbai and Ahmedabad in India. It has amended its Memorandum of Association on 1st June, 2022 and closed branch office situated at Mumbai. Referring to the provisions of the Companies Act, 2013 advise the company on the following matters:

(i) Compliance procedure as regards to amendment of Memorandum of Association.

(ii) Compliance procedure as regards to closure of Mumbai office and discontinuing submission of documents to the Registrar of Companies afterwards. ***(4 Marks)***

(c) One NGO made a complaint before Special Court against Rishabh, alleged to be indulged into the money laundering activities. In the same complaint, he has been accused of other offences under the Code of Criminal Procedure, 1973.

Referring to the provisions of the Prevention of Money Laundering Act, 2002, examine the following:

(i) Can Special Court take cognizance of alleged offence complained of?

(ii) Can Police officer initiate investigation on receiving a Complaint?

(iii) Can Special Court initiate trial under the Code of Criminal Procedure, 1973 while trying an offence under this Act? ***(3 Marks)***

(d) Mr. Wilson, a notorious person, was caught in possession of Counterfeit Currency Notes, an offence specified under Part A- Paragraph I of the Schedule of the Prevention of Money Laundering Act, 2002. State the Punishment that can be awarded to him under the above Act. Also identify the Punishment for the offence specified under Part A Paragraph 2 of the Schedule of the Prevention of Money Laundering Act, 2002. ***(3 Marks)***

Answer

(a) Section 328 of the Companies Act, 2013 relates with when any transaction may be treated as fraudulent preference.

Where a company has given preference to a person who is-

- one of the creditors of the company, or
- a surety or guarantor for any of the debts or other liabilities of the company,

and the company does anything or suffers anything done which has the effect of putting that person into a position which, in the event of the company going into liquidation, will be better than the position he would have been in if that thing had not been done prior to 6 months of making winding up application, the Tribunal, if satisfied that, such transaction is a fraudulent preference may order as it may think fit for restoring the position to what it would have been if the company had not given that preference.

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As per the facts given, Ganga Textiles Limited was running in loss for last three financial years and its financial position was also bad. The company created a legal mortgage on some of its immovable properties in favour of bank in good faith that it could get further advances from the bank that could be utilized to revive the company.

Some creditors filed a winding up petition in the Tribunal and also an order of the winding up has been passed.

According to above stated provision in the light of the given situation, creation of mortgage on immovable property with the bank with an intent of getting further advances from the bank for its revival was done by the company in good faith in the ordinary course of business. Further, as per requirement of the law, the said legal mortgage was neither in favour of any creditor of the company nor for a surety or guarantor of the company for any debts/liabilities.

Therefore, here the creation of legal mortgage by the company in favour of the Bank will not amount to fraudulent preference.

(b) **According to section 380 of the Companies Act, 2013 read with Rule 8 of** the Companies (Registration of Foreign Companies) Rules, 2014, following shall be the compliances duly required to be fulfilled by the CNC Limited, a foreign company, for closure of one of its branch of Mumbai office.

(i) W.r.t. Compliance procedure as regards to amendment of Memorandum of Association

According to Section 380 (3) of the Act which provides that where any alteration is made or occurs in the documents delivered to the Registrar under section 380, the foreign company shall, within 30 days of such alteration, deliver to the Registrar for registration, a return containing the particulars of the alteration in the prescribed form. The Companies (Registration of Foreign Companies) Rules, 2014, has prescribed that the return containing the particulars of the alteration shall be filed in form *FC-2* along with prescribed fees.

As in the instance, the CNC Limited has amended its Memorandum of Association on 1st of June 2022 and closed its branch office of Mumbai. This altered document is required to be delivered to Registrar by CNC Limited within 30 days i.e. latest by 1st of July 2022.

(ii) **W.r.t. compliance procedure as regards to closure of Mumbai office and discontinuing submission of documents to the registrar of companies afterwards**

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If any foreign company ceases to have a place of business in India, it shall forthwith give notice of the fact to the Registrar, and from the date on which such notice is so given, the obligation of the company to deliver any document to the Registrar shall cease, provided it has no other place of business in India.

Here, in the given case, CNC Limited has still Ahmedabad as a place of business in India. So, will continue the submission of document to the Registrar even after the closure of Mumbai office.

(c) **(i)** **Cognizance of offence by Special Court:** According to section 45 of the Prevention of Money Laundering Act, 2002, the Special Court cannot take cognizance of any offence punishable under section 4 of the Act, unless a complaint in writing is made by:

(a) The Director or

(b) Any officer of the Central Government or a State Government authorized in writing by the Central Government by a general or special order made by that Government.

Accordingly, NGO is not eligible to file complaint before special court against Rishabh alleged to be indulged into the money laundering activities.

Therefore, Special court cannot take cognizance of alleged offence complained of against Rishabh.

(ii) As per the law, Police officer shall investigate into an offence under this Act only when specifically authorised, by the Central Government by a general or special order, and, subject to such conditions as may be prescribed.

Here in the given, Police officer cannot initiate investigation on receiving a compliant from NGO.

(iii) Section 44 of the Prevention of Money Laundering Act, 2002, provides that this Act overrides the provisions of the Code of Criminal Procedure, 1973. So, Special Court while trying Scheduled Offence or offence of money laundering shall hold trial in accordance with the provision of Code of Criminal Procedure as it applies to a trial before a court of session.

(d) According to section 4 of the Prevention of Money Laundering Act, 2002, whoever commits the offence of money-laundering shall be punishable with rigorous imprisonment for a term which shall not be less than three years but which may extend to seven years and shall also be liable to fine.

Accordingly, Mr. Wilson, a notorious person, was caught with the possession of counterfeit currency notes, is an offence specified under Part A-Paragraph 1 of the Schedule of the PMLA. So, he will be punished with rigorous imprisonment for a term of three years to seven years with fine.

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Where the proceeds of crime involved in money-laundering relate to any offence specified under paragraph 2 of Part A of the Schedule, the punishment will be for a term of three years to ten years with fine.

Question 4

(a) *Meera is a highly qualified professional and independent director in several listed companies. Referring to the provisions of the Securities and Exchange Board of India Act, 1992 and SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, answer the following questions:*

(i) *In how many listed companies she can be appointed as a director and independent director?*

(ii) *Whether the above number will be changed if she is serving as a whole-time director in a listed entity?*

(iii) *In how many committees she can be member?*

(iv) *In how many committees she can be appointed as Chairperson?* ***(4 Marks)***

(b) *The Central Government has issued directions on the question of policy from time-to-time to the Securities and Exchange Board of India (SEBI / Board). However, SEBI defied the orders on many occasions and hence, the Central Government superseded the Board. Referring to the provisions of the Securities and Exchange Board of India Act, 1992 analyse the validity of the order of the Central Government and answer the following:*

(i) *The powers of the Central Government to supersede the Board and reasons therefor.*

(ii) *Eligibility of person's who vacated their office on supersession of the Board for appointment on the reconstituted board.* ***(4 Marks)***

(c) *Mr. Mustafa is contesting an election as an authorised candidate of a registered political party. He has received, during the financial year 2021-22, a contribution of INR 25,00,000 from his brother Mr. Rehman who is a citizen of and living in UAE. Mr. Mustafa has obtained this money to defray his election expenditure. Referring to the provisions of the Foreign Contribution (Regulation) Act, 2010 (FCRA) advise whether Mr. Mustafa, by accepting foreign contribution, has violated the provisions of FCRA.* ***(3 Marks)***

(d) *There was some dispute between Mr. Pankaj and Mr. Arun which could not be resolved smoothly by them and was referred to the Arbitral Tribunal having three arbitrators, by virtue of the arbitration agreement between them. Two of the arbitrators were of the opinion that Mr. Pankaj has to pay a compensation of ₹ 2 crore to Mr. Arun. The third arbitrator was of the opinion that Mr. Arun is not eligible to get any compensation from Mr. Pankaj. The award was then written and signed by the first two arbitrators, while the third arbitrator refused to sign. The fact that the third arbitrator refused to sign and the reason behind that was stated in the award. Mr. Pankaj contended that since all the arbitrators did not sign, the award is invalid. Decide whether the contention of Mr. Pankaj is tenable as per the provisions of the Arbitration and Conciliation Act, 1996.* ***(3 Marks)***

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Answer

(a) As per the given information, Meera is a highly professional and independent director in several listed companies. Following are the answers as per the Regulations 17A and 26 of the SEBI (LODR), Regulation 2015:

(i) Regulation 17A(1) of the SEBI (LODR) Regulations, 2015 provides that a person shall not be a director or independent director in more than seven listed entities.

Hence, Meera can be appointed as a director and independent director in maximum 7 listed companies.

(ii) Regulation 17A(2) of the SEBI (LODR) Regulations, 2015 provides that any person who is serving as a WTD / MD in any listed entity shall serve as an independent director in not more than 3 listed entities.

Hence Meera, besides holding the position of WTD, can serve as an Independent Director maximum up to 3 listed companies only.

(iii) As per Regulation 26 of the SEBI (LODR) Regulations, 2015, a director shall not be a member in more than ten committees across all listed entities.

So, Meera can be a member in maximum ten committees.

(iv) As per Regulation 26 of the SEBI (LODR) Regulations, 2015, a director shall not act as chairperson of more than five committees across all listed entities.

So, Meera can be appointed as chairperson in maximum five committees.

(b) (i) **Power of Central Government to supersede the Board**: According to section 17 of the Securities and Exchange Board of India Act, 1992, if at any time the Central Government is of opinion that the Board has persistently made default in complying with any direction issued by the Central Government under this Act or in the discharge of the functions and duties imposed on it by or under the provisions of this Act and as a result of such default the financial position of the Board or the administration of the Board has deteriorated, then in such case the Central Government may, by notification, supersede the Board for such period, not exceeding six months, as may be specified in the notification.

Thus, the powers of Central Government to supersede the Board is valid due to persistent committing of default in complying with directions issued by the Central Government on the question of policy from time to time.

(ii) Further section 17(3) of the Securities and Exchange Board of India Act, 1992 states that on the expiration of the period of supersession specified in the notification issued, the Central Government may reconstitute the Board by a fresh appointment and in

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such case any person or persons who vacated their offices, shall not be deemed disqualified for appointment.

Provided that the Central Government may, at any time, before the expiration of the period of supersession, take action under this sub-section and appoint such person/s by a fresh appointment.

Hence, the person/s who vacated their office on supersession of the Board will be eligible for appointment on reconstituted Board.

(c) As per section 3 of the Foreign Contribution (Regulation) Act, 2010, no foreign contribution shall be accepted by any candidate for election.

Further section 21 of the Act states that every candidate for election, who had received any foreign contribution, at any time within one hundred and eighty days immediately preceding the date on which he is duly nominated as such candidate, shall give, within such time and in such manner as may be prescribed, an intimation to the Central Government or prescribed authority or both as to the amount of foreign contribution received by him, the source from which, and the manner in which, such foreign contribution was received and the purposes for which and the manner in which such foreign contribution was utilised by him.

Accordingly, in the given case, though section 3 of the FCRA prohibits acceptance of foreign contribution by any candidate for election but in terms of section 21, it is permissible, to the duly nominated candidate contesting an election as an authorised candidate of a registered political party. He shall give, an intimation to the Central Government or prescribed authority or both as to the amount of foreign contribution received by him, the source from which, and the manner in which, such foreign contribution was received and the purposes for which and the manner in which such foreign contribution was utilised by him.

Hence, Mr. Mustafa, if accepted foreign contribution in compliance with the requirement as provided under section 21, can be said to have not violated the provisions of FCRA.

(d) As per the Arbitration and Conciliation Act, 1996, all decisions, including an award, must be made through majority. An award must also be complete concerning all issues that are submitted to the Arbitral Tribunal for adjudication.

Further, section 31(1)(a) requires an award to be in writing and having the signature of the members of the arbitral tribunal.

It is not an award unless these two conditions are fulfilled.

A mandatory requirement for an award is that it should be reasoned. Failure to state reasons would make the award invalid. Presence of reason would show that the arbitrators had applied their minds to the matter, taken into consideration all materials put before them and only then arrived at a decision. The only exception is when the parties have agreed that no reasons need be given for the award.

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Thus, the award given is in compliance as it was written and signed by majority, with reason behind the refusal to sign by the third member. Accordingly, the contention of Mr. Pankaj is not tenable. Hence, the award is valid.

Question 5

(a) *Sujeet, a registered valuer, was appointed by Him Limited for valuation of its goodwill for the proposed joint venture with its suppliers. A sum of ₹ five lakh was given to him towards remuneration. Later, it was found that Sujeet had given lower valuation intentionally to defraud the company which caused a loss of ₹ one crore to the company. As per the Companies (Registered Valuers and Valuation) Rules, 2017 state the remedies available to Him Limited and also mention the consequences to be faced by Sujeet for the default.*

(4 Marks)

(b) *Mr. Sohel and Sushil, joint shareholders of Pragati (Nidhi) Limited have applied for a fresh loan whereas other member Mr. Sahil has applied for a further loan who has defaulted the repayment of earlier loan borrowed from the Nidhi. The name of Mr. Sohel appears first in the register of members. The latest audited financial statements of the Nidhi as on 31 March, 2022 show that the total amount of deposits from its members is ₹ 5 crore. The financial statements further show that the Nidhi is continuously in losses during the last three financial years 2019-20, 2020-21 and 2021-22. You are required to decide the eligibility and maximum quantum of loan that can be sanctioned to Mr. Sohel and Mr. Sahil as per the provisions of the Companies Act, 2013.* ***(4 Marks)***

(c) (i) *Star Bank of India Ltd. (SBI) has provided a loan of ₹ 50 Lakh to SMALL Private Limited which is a small company under the Companies Act, 2013. The Company defaulted the repayment as a result of which SBI wants to initiate the Corporate Insolvency Resolution Process (CIRP) against the company to settle the matter within a period of three months approximately. The Solicitor advised the Bank that the maximum period allowed for completion of CIRP is 270 days. Referring to the provisions of the Insolvency and Bankruptcy Code, 2016 advise the Bank the measures available, if any, for speedy disposal of the process as desired by it.*

(ii) *Harsha Fabrics Private Limited (Corporate Debtor) has taken a loan of ₹ 30 Lakh from a financial institution (Financial Creditor) for business purpose. On filing an application by the financial creditor, the Corporate Insolvency Resolution Process (CIRP) was commenced declaring moratorium by order of the Adjudicating Authority on 30th May, 2022. The High Court having jurisdiction, in disposing of the pending petition of some other creditors which was filed prior to 30th May, 2022, passed an order for auction of assets of the Corporate Debtor on 6th June, 2022.*

Referring to the provisions of the Insolvency and Bankruptcy Code, 2016 advise the financial creditor whether the order of High Court is valid and can it be challenged?

(6 Marks)

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Answer

(a) In the given question, Sujeet, a registered valuer, had given lower valuation of goodwill, with the intention to defraud the company. This caused loss to Him Limited. The remedies mentioned in Rule 9 of the Companies (Registered Valuers and Valuation) Rules, 2017, shall be applicable to Him Limited, which is stated below:

A complaint may be filed against a registered valuer or registered valuers organisation before the authority in person or by post or courier along with a non-refundable fees of ₹ 1,000 in favour of the authority and the authority shall examine the complaint and take such necessary action as it deems fit.

Further, the consequences/ liabilities to be faced by Sujeet, as per section 247 of the Companies Act, 2013, are mentioned below:

1. If a valuer contravenes the provisions of this section or the rules made thereunder, the valuer shall be liable to a penalty of fifty thousand rupees.

   However, if the valuer has contravened such provisions with the intention to defraud the company or its members, he shall be punishable with imprisonment for a term which may extend to 1 year and with fine which shall not be less than ₹ 1 Lakh but which may extend to ₹ 5 lakh.

2. Where a valuer has been convicted for defrauding the company or member (as mentioned above), he shall be liable to—

   (a) refund the remuneration received by him to the company; and

   (b) pay for damages to the company or to any other person for loss arising out of incorrect or misleading statements of particulars made in his report.

(b) Rule 15 of the Nidhi Rules, 2014, deals with Loans is as follows:

(a) A Nidhi shall provide loans only to its members.

(b) The loan given by a Nidhi to a member shall be subject to seven lakh fifty thousand rupees, where the total amount of deposits of such Nidhi from its members is more than two crore rupees but less than twenty crore rupees;

Provided that where a Nidhi has not made profits continuously in the three preceding financial years, it shall not make any fresh loans exceeding fifty per cent. of the maximum amounts of loans specified.

Provided further that a member shall not be eligible for any further loan if he has borrowed any earlier loan from the *Nidhi* and has defaulted in repayment of such loan.

Here, the amount of deposits shall be calculated on the basis of the last audited annual financial statements.

In the light of the above provisions:

1. The maximum amount of fresh loans that the Nidhi may give to member = ₹ 7,50,000.

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Since, the company is incurring losses during the last three years, so, the eligible amount for giving fresh loans will be= 50% of 7,50,000= ₹ 3,75,000.

The maximum amount that can be given to Mr. Sohel is ₹ 3,75,000.

2. Mr. Sahil is not eligible for any further loan as he has defaulted in repayment of earlier loan borrowed from Pragati (Nidhi) Limited.

(c) Sections 55 to 58 of the Insolvency and Bankruptcy Code, 2016 deals with the fast track corporate insolvency resolution process for corporate persons.

(i) **Manner of initiating fast track corporate insolvency resolution process:** An application for fast track corporate insolvency resolution process may be filed by a creditor or corporate debtor as the case may be, along with:

(a) the proof of the existence of default as evidenced by records available with an information utility or such other means as may be specified by the Board; and

(b) such other information as may be specified by the Board to establish that the corporate debtor is eligible for fast track corporate insolvency resolution process.

Manner of initiating fast track corporate insolvency resolution process: An application under fast track insolvency resolution can be made in respect of prescribed corporate debtor, in which small company under section 2(85) of Companies Act is also prescribed.

Time period for completion of fast track corporate insolvency resolution process: The fast track corporate insolvency resolution process shall be completed within a period of ninety days from the insolvency commencement date. The period of CIRP can be extended by 45 days if required by Adjudicating Authority.

In line with above provisions Star Bank Limited can go in for speedy disposal of CIRP against SMALL Private Limited (a small company).

(ii) According to the section 14(1) of the Insolvency and Bankruptcy Code, 2016, on the insolvency commencement date, the Adjudicating Authority shall by order, declare moratorium prohibiting the institution of suits or continuation of pending suits or proceedings against the corporate debtor including execution of any judgment, decree or order in any court of law, tribunal, arbitration panel or other authority.

In the given case, moratorium was declared by the order of the Adjudicating Authority commencing CIRP on 30th May, 2022. The High Court passed an order of pending petition on 6th June, 2022 (i.e. after the moratorium was declared). As, section 14(1) prohibits execution of decree or order of the court during moratorium period, therefore, the passing of order of High Court is not valid and yes it can be challenged.

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Question 6

(a) Mr. Ramesh was appointed as a whole-time director and was heading the marketing department in Sun Moon Pharma Limited. As a cost saving measure during pandemic he was removed from the office as whole-time director. Mr. Ramesh demanded compensation for loss of office. Explaining the relevant provisions of the Companies Act, 2013, state whether he is entitled to compensation. If yes, how the compensation amount will be calculated?

OR

Ms. Vishakha who is working as a Managing Director in MNO Limited has received an offer from Vishal Steel Limited for the post of the Managing Director. Effective capitals of MNO Limited and Vishal Steel Limited are ₹ 10 Crore and ₹ 20 Crore respectively as per the latest audited financial statements. While accepting the offer of Vishal Steel Limited she put a condition that she will work as a managing director in both companies simultaneously and draw remuneration from each of them. Referring to the provisions of the Companies Act, 2013 advise her about the total maximum yearly remuneration she can draw from both the companies together, if entitled? ***(4 Marks)***

(b) Modern Limited wants to borrow from banks an amount more than its paid-up share capital, free reserves and share premium. As per general rule of governance the companies are governed by directors, Whether the Board of directors is authorised to do so? If not, what would be the procedure to be followed by the company? Whether your answer would be different if total loans include temporary loans obtained from its banker in ordinary course of business? ***(4 Marks)***

(c) During the proceedings before Adjudicating authority under the Prevention of Money Laundering Act, 2002 a notice to attach the property (a car) was issued to Shyam. Shyam pleaded that his car was not used in the money laundering activities. Whether his plea can be accepted and the said notice be quashed under the said act? Explain. ***(3 Marks)***

(d) Explain the duties of Resolution Professional before initiation of pre-packaged insolvency resolution process as per the Insolvency and Bankruptcy Code, 2016. ***(3 Marks)***

Answer

(a) Compensation for loss of office of managing or whole-time director or manager [Section 202 of the Companies Act, 2013]

A company may make payment to a Managing Director (MD) or Whole-time director (WTD) or Manager (but not to any other director) by means of:

- compensation for loss of office, or
- as consideration for retirement from office, or
- in connection with such loss or retirement.

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Here, in the given instance Mr. Ramesh the whole time director was forced to be removed from office during pandemic as cost saving measure. Yes, he is entitled for compensation.

Calculation of compensation: The compensation shall be calculated on the basis of the average remuneration earned by him during a period of three years immediately preceding the date on which he ceased to hold such office, or where he held the office for less than three years, then for such shorter period.

The above compensation shall not exceed the remuneration he would have earned if he would have been in office for the remainder of his term or three years, whichever is shorter.

OR

As per Schedule V Part II Section I, a company having profits in financial year may pay remuneration to a managerial person or persons not exceeding the limits specified in section 197 of the Companies Act, 2013.

According to section 197(1), the total managerial remuneration payable by a public company, to its directors including managing director and whole-time director, and its manager in respect of any financial year shall not exceed eleven percent of the net profits of that company for that financial year computed in the manner laid down in section 198 except that the remuneration of the directors shall not be deducted from the gross profits.

Provided that the company in general meeting may authorize the payment of remuneration exceeding eleven percent of the net profits of the company, subject to the provisions of Schedule V.

Provided further that, except with the approval of the company in general meeting by a special resolution, the remuneration payable to any one managing director whole-time director or manager shall not exceed five percent of the net profits of the company and if there is more than one such director, remuneration shall not exceed ten percent of the net profits of the net profits to all such directors and manager taken together.

As per Schedule V Part II Section II where in any financial year during the currency of tenure of a managerial person, a company has no profits or its profits are inadequate, it may pay remuneration to the managerial person not exceeding the limits specified therein.

As per Schedule V Part II Section V, a managerial person shall draw remuneration from one or both companies, provided that the total remuneration drawn from the companies does not exceed the higher maximum limit admissible from any one of the companies of which he is a managerial person.

According to the given facts, Ms. Vishakha is working as a Managing Director in MNO Limited. She received an offer from Vishal Steel Limited for the post of the Managing Director. The effective Capital of the MNO Limited and Vishal Steel Limited are ₹ 10 Crore and ₹ 20 Crore respectively.

In view of above, if the companies are having Profits, the remuneration payable will be as per section 197(1) of the Companies Act, 2013. Overall limit of managerial remuneration

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to the directors including managing director, whole time director and manager will be 11% of the net profits of the company for that financial year. If there is one Managing director, 5% of the net profits of the company for that financial year. However, these limits may be increased in compliance with requirement of law.

In case the companies have no profits or its profits are inadequate the maximum remuneration under the both companies, for which Ms. Vishakha is entitled will be Rs. 84 lakh as per Section II-–Part II- Schedule V of the Companies Act, 2013.

The question also provides that while accepting the offer of Vishal Steel Limited, Ms. Vishakha also put a condition that she will work as a managing director in both companies simultaneously and draw remuneration from each of them.

In light with the given provision contained in Section V –Part II- Schedule V of the Act, Ms. Vishakha is entitled to draw remuneration from one or both companies but the total remuneration drawn from the companies does not exceed the higher maximum limit admissible from any one of the companies.

(b) According to Section 180 (1)(c) of the Companies Act, 2013, the Board shall exercise the powers to borrow money, where the money to be borrowed, together with the money already borrowed by the company will exceed aggregate of its paid-up share capital, free reserves and securities premium apart from temporary loans obtained from the company's bankers in the ordinary course of business only with the consent of the company by a special resolution.

'Borrowings' (including loans raised for meeting financial expenditure of a capital nature) are not to include temporary loans which are obtained by the company from its bankers in the ordinary course of business.

Limit on 'borrowings' need to be specified: Section 180 (2) requires that every special resolution passed by the company in general meeting in relation to the 'borrowings' shall specify the total amount up to which monies may be borrowed by the Board of Directors.

Debt raised in excess of the specified limit [Section 180 (5)]: If a company incurs debt in excess of the limit imposed i.e. more than the 'total amount' specified in the special resolution, it shall not be valid or effectual from the point of view of lender unless such lender proves that he advanced the loan in good faith and without knowledge that the limit imposed had been exceeded. Thus, lender has to be fully cautious before extending any loan to a company. The loaned amount must not be in excess of the limit imposed otherwise it shall not be legally enforceable against the company. In other words, the lender must be aware in no uncertain terms the implications of Section 180 (5) and must carefully check the financial statements as well as the special resolution, if any, passed by the company before extending any loan facility to it.

In view of above, the Board is not authorised to borrow from banks an amount more than its paid-up share capital, free reserve and share premium. Hence, in the present case the Board need to pass a special resolution.

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Exclusion of temporary loans: Since, temporary loans are obtained from its bankers in ordinary course of business, so they are excluded from the limits computed for borrowings. So, it will not effect on the total borrowing power of the company.

(c) According to section 8 of the Prevention of Money Laundering Act, 2002, on receipt of a complaint under section 5 (5), if the Adjudicating Authority has reason to believe that any person has committed an offence under section 3 or is in possession of proceeds of crime, it may serve a notice on such person calling upon him to indicate the sources of his income, earning or assets, out of which or by means of which he has acquired the property attached, the evidence on which he relies, and other relevant information and particulars, and to show cause why all or any of such properties should not be declared to be the properties involved in money-laundering and confiscated by the Central Government.

Thus, the plea of Shyam shall not be accepted and notice will be served on him, for attachment of property.

(d) **Duties of resolution professional before initiation of pre-packaged insolvency resolution process.**

According to section 54B of the Insolvency and Bankruptcy Code, 2016, the insolvency professional, proposed to be appointed as the resolution professional, shall have the following duties commencing from the date of the approval under clause (e) of sub-section (2) of section 54A, namely:—

(a) prepare a report in prescribed form, confirming whether the corporate debtor meets the requirements of section 54A, and the base resolution plan conforms to the requirements referred to in section 54A;

(b) file such reports and other documents, with the Board, as may be specified; and

(c) perform such other duties as may be specified.

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