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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

May 2022

PAPER – 1 : FINANCIAL REPORTING

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

Wherever necessary, suitable assumptions may be made and disclosed by way of a note.

Working notes should form part of the answers.

Question 1

(a) The draft Balance Sheet of JAY Ltd. and KAY Ltd. as at 31st March 2021 is given below:

PARTICULARS	*JAY Limited (₹ in lakh)*	*KAY Limited (₹ in lakh)*
ASSETS		
NON-CURRENT ASSETS		
Property, Plant & Equipment	*400*	*500*
Investments	*450*	*120*
CURRENT ASSETS		
Inventories	*180*	*130*
Financial Assets		
- Trade Receivables	*520*	*270*
- Cash & Cash Equivalents	*260*	*145*
- Others	*350*	*175*
TOTAL	*2,160*	*1,340*
EQUITY AND LIABILITIES		
EQUITY		
Share Capital *- JAY Limited: Equity Shares of ₹ 10 each* *- KAY Limited: Equity Shares of ₹ 100 each*	*600*	 *450*
OTHER EQUITY	*725*	*210*
NON-CURRENT LIABILITIES		
Financial Liabilities		
- Long Term Borrowings	*350*	*250*
Long Term Provisions	*70*	*80*
Deferred Tax	*40*	*20*

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CURRENT LIABILITIES		
Financial Liabilities		
- Short Term Borrowings	*125*	*145*
- Trade Payables	*250*	*185*
TOTAL	*2,160*	*1,340*

Other information:

a. *JAY Ltd. acquired 75% shares of KAY Ltd. on 1st April, 2021 by issuing its own shares in the ratio of 2 shares of JAY Ltd. for every 3 shares of KAY Ltd. The fair value of the shares of JAY Ltd. was ₹ 50 per share.*

b. *The fair value exercise resulted in the following:*

   i. *Fair value of Property, Plant & Equipment of KAY Ltd. on 1st April, 2021 was ₹ 425 lakh;*

   ii. *JAY Ltd. also agreed to pay an additional payment as consideration that is higher of ₹ 45 lakh and 30% of any excess profits in the first year, after acquisition, over its profits in the preceding 12 months made by KAY Ltd. This additional amount will be due after 3 years. KAY Ltd. has earned ₹ 15 lakh profit in the preceding year and expects to earn another ₹ 20 lakh;*

   iii. *In addition to the above, JAY Ltd. also had agreed to pay one of the founder shareholder a payment of ₹ 22 lakh provided he stays with the Company for 3 years after acquisition;*

   iv. *KAY Ltd. had certain equity settled share based payment award (original award) which got replaced by the new awards issued by JAY Ltd. As per the original terms, the vesting period was 5 years and as of the acquisition date the employees of KAY Ltd. have already served 2 years of service. As per the replaced awards, the vesting period has been reduced to 1 year (1 year from the acquisition date). The fair value of the award on the acquisition date was as follows:*

      - *Original award - ₹ 6 lakh*
      - *Replacement award - ₹ 9 lakh*

   v. *KAY Ltd. had a lawsuit pending with a customer who made a claim of ₹ 70 lakh. Management reliably estimated the fair value of the liability to be ₹ 7.5 lakh;*

   vi. *The applicable tax rate for both entities is 30%.*

You are required to prepare consolidated balance sheet of JAY Ltd. as on 1st April, 2021. Assume 10% per annum discount rate. Management notes and working notes should form part of your answer. ***(15 Marks)***

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(b) *In November 2021, an Ind AS compliant Company entered into a loan agreement with a bank. The loan is repayable in 6 equal annual installments starting from November 2026. One of the loan covenants is that an amount equivalent to the loan amount should be contributed by the promoters of the Company by 4th March, 2022, failing which the loan becomes payable on demand.*

As on 4th March, 2022, the Company has not been able to get the promoter's contribution. On 5th March, 2022, the Company approached the Bank and immediately obtained a grace period up to 30th June, 2022 to get the promoter's contribution.

The bank cannot demand immediate repayment during the grace period.

The annual reporting period of the Company ends on 31st March, 2022. You are required to respond to the following:

(i) As at 31st March, 2022, how should the Company classify the loan?

(ii) Assume that it may not be able to get the promoter's contribution by the due date, the Company approached the Bank in January 2022 and got the compliance date extended up to 30th June, 2022 for getting promoter's contribution. Will the loan classification as at 31st March, 2022 be different from (i) above? ***(5 Marks)***

Answer

(a) Consolidated Balance Sheet of JAY Ltd. as on 1st April, 2021 **(₹ in lakh)**

	Amount
Assets	
Non-Current Assets:	
Property, plant and equipment	825.00
Financial assets	
Investment	570.00
Current assets:	
Inventories	310.00
Financial assets	
Trade receivables	790.00
Cash and cash equivalents	405.00
Others	525.00
Total	3,425.00
Equity and Liabilities	
Equity	
Share capital - Equity shares of ₹ 10 each	622.50

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Other Equity	1,120.38
Non-controlling Interest	150.56
Non-Current liabilities:	
Financial Liabilities	
Long term borrowings	600.00
Long term provisions	183.81
Deferred tax	35.25
Current Liabilities:	
Financial Liabilities	
Short term borrowings	270.00
Trade payables	435.00
Provision for Lawsuit damages	7.50
Total	3,425.00

Management Notes:

a. As per Ind AS 103, the acquirer is required to record the assets and liabilities acquired at their respective fair value. Accordingly, the PPE of KAY Ltd. will be recorded at ₹ 425 lakh.

b. The value of replacement award is allocated between consideration transferred and post combination expense. The portion attributable to purchase consideration is determined based on the fair value of the replacement award for the service rendered till the date of the acquisition. Accordingly, ₹ 2.4 lakh (6 x 2/5) is considered as a part of purchase consideration and is credited to JAY Ltd. equity as this will be settled in its own equity. The balance of ₹ 6.60 lakh (₹ 9 lakh – ₹ 2.4 lakh) will be recorded as compensation expense in the post combination financial statements over the remaining life, which is 1 year in this scenario.

c. There is a difference between contingent consideration and deferred consideration. In the given case ₹ 45 lakh is the minimum payment to be paid after 3 years and accordingly will be considered as deferred consideration. The other element is if company meet certain target, then they will get 30% of that or ₹ 45 lakh whichever is higher. In the given case, the minimum what is expected to be paid has been considered and the fair value of the contingent consideration has been considered as zero. The impact of time value on deferred consideration has been given @ 10%.

d. The additional consideration of ₹ 22 lakh to be paid to the founder shareholder is contingent to him/her continuing in employment and hence this will be considered

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as employee compensation and will be recorded as post combination expenses in the income statement of JAY Ltd.

Working Notes:

1. Computation for Purchase consideration

Particulars		*Amount (₹)*
Share capital of KAY Ltd.		4,50,00,000
Number of shares	4,50,000	
Shares to be issued 3:2	3,00,000	
Fair value ₹ per share		50
		₹ in lakh
PC (3,00,000 x 75% x ₹ 50 per share) (A)		112.50
Deferred consideration after discounting ₹ 45 lakh for 3 years @ 10% (P.V. Factor 0.7513) (B)		33.81
Replacement award market-based measure of the acquiree award (6) x ratio of the portion of the vesting period completed (2) / greater of the total vesting period (3) or the original vesting period (5) of the acquiree award ie (6 x 2/5) (C)		2.40
PC in lakh (A+B+C)		148.71

2. Allocation of Purchase price

Particulars	*Book value (A)*	*Fair value (B)*	*FV adjustment (A-B)*
Property, plant and equipment	500.00	425.00	(75.00)
Investment	120.00	120.00	
Inventories	130.00	130.00	
Financial assets:			
Trade receivables	270.00	270.00	
Cash and cash equivalents	145.00	145.00	
Others	175.00	175.00	
	1,340.00	1,265.00	(75.00)
Less: Long term borrowings	(250.00)	(250.00)	
Long term provisions	(80.00)	(80.00)	
Deferred tax	(20.00)	(20.00)	

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Short term borrowings	(145.00)	(145.00)	
Trade payables	(185.00)	(185.00)	
Contingent liability	-	(7.50)	(7.50)
Net assets (X)	660.00	577.50	(82.50)
Deferred tax asset on FV adjustment (82.50 x 30%) (Y)		24.75	
Net assets (X+Y)		602.25	
Non-controlling interest (602.50 x 25%) rounded off		150.56	
Purchase consideration (PC)		148.71	
Capital Reserve (Net assets – NCI – PC)		302.98	

3. Computation of consolidated amounts of consolidated financial statements

(₹ in lakh)

	JAY Ltd.	*KAY Ltd. (pre-acquisition)*	*PPA Allocation*	*Total*
Assets				
Non-current assets:				
Property, plant and equipment	400.00	500.00	(75.00)	825.00
Investment	450.00	120.00		570.00
Current assets:				
Inventories	180.00	130.00		310.00
Financial assets:				
Trade receivables	520.00	270.00		790.00
Cash and cash equivalents	260.00	145.00		405.00
Others	350.00	175.00	-	525.00
Total	2,160.00	1,340.00	(75.00)	3,425.00

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Equity and Liabilities				
Equity				
Share capital - Equity shares of ₹ 10 each	600.00			
Shares allotted to KAY Ltd. (W.N.1) (3,00,000 x 75% x ₹ 10 per share)			22.50	622.50
Other Equity	725.00			1,120.38
Replacement award (W.N.1)			2.40	
Security Premium (W.N.1) (3,00,000 shares x 75% x ₹ 40)			90.00	
Capital Reserve (W.N.2)			302.98	
Non-controlling interest (W.N.2)	-		150.56	150.56
Non-current liabilities:				
Financial liabilities				
Long term borrowings	350.00	250.00		600.00
Long term provisions (W.N.1)	70.00	80.00	33.81	183.81
Deferred tax (W.N.2)	40.00	20.00	(24.75)	35.25
Current liabilities:				
Financial liabilities				
Short term borrowings	125.00	145.00		270.00
Trade payable	250.00	185.00		435.00
Liability for lawsuit damages	-	-	7.50	7.50
Total	2,160.00	680.00	585.00	3,425.00

(b) (a) Paragraph 75 of Ind AS 1, inter alia, provides that an entity classifies the liability as non-current if the lender agreed by the end of the reporting period to provide a period of grace ending at least twelve months after the reporting period, within

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which the entity can rectify the breach and during which the lender cannot demand immediate repayment.

In the present case, following the default, grace period within which an entity can rectify the breach is less than twelve months after the reporting period. Hence as on 31st March, 2022, the loan will be classified as current.

(b) Ind AS 1 deals with classification of liability as current or non-current in case of breach of a loan covenant and does not deal with the classification in case of expectation of breach. In this case, whether actual breach has taken place or not is to be assessed on 30th June, 2022, i.e., after the reporting date. Consequently, in the absence of actual breach of the loan covenant as on 31st March, 2022, the loan will retain its classification as non-current.

Question 2

(a) PK Ltd. has a net worth of ₹ 450 crore. It manufactures bathroom accessories. The sales of the company are affected due to low demand. The company has provided following information:

Particulars	*Amount (₹ in crore) for year ended*			
	31.3.2022	*31.3.2021*	*31.3.2020*	*31.3.2019*
Net Profit	*3.50*	*7.75*	*4.25*	*4.00*
Sales (Turnover)	*600.00*	*850.00*	*700.00*	*710.00*

During the financial year 2021-2022, PK Ltd. decided that on sale of certain selected items of bathroom accessories @ ₹ 0.50 paisa per unit sold will be contributed to the 'Save Water Foundation' which will qualify as a Corporate Social Responsibility (CSR) expense as per Schedule VII to the Companies Act, 2013.

Consequently, by the year end, the Company recognized, ₹ 1,50,000 as CSR expenditure. However, only 50% of the aforesaid amount was paid to the Foundation by the end of the year ending 31st March, 2022. Discuss:

(i) Whether PK Ltd. has an obligation to form a CSR committee as the applicability criteria is not satisfied in the financial year 2021-2022? The net worth has always remained below the applicability threshold.

(ii) Whether ₹ 1,50,000 will qualify as CSR expenditure under section 135 of the Companies Act, 2013? ***(6 Marks)***

(b) ANANDAM Ltd. enters into a contract with a customer on 1st April, 2019 for sale of a machine and spare parts. The manufacturing lead time for the machine and spare parts is 3 years.

On completion of manufacturing, ANANDAM Ltd. demonstrates that the machine and spare parts meet the agreed-upon specifications in the contract. The promises to

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transfer the machine and spare parts are distinct and result in two performance obligations each of which will be satisfied at a point in time.

On 31st March, 2022, the customer pays for the machine and spare parts, but only takes the physical possession of the machine. Although the customer inspects and accepts the spare parts, the customer requests that the spare parts be stored at ANANDAM Ltd.'s warehouse because of its close proximity to the customer's factory.

The customer has legal title to the spare parts and the parts can be identified as belonging to the customer. ANANDAM Ltd. stores the spare parts in a separate section of its warehouse and the parts are ready for immediate shipment at the customer's request. ANANDAM Ltd. expects to hold the spare parts for one to three years and does not have the authority to use the spare parts or direct them to another customer.

Determine how the revenue will be recognized by ANANDAM Ltd. for the different performance obligations as per Ind AS 115? ***(6 Marks)***

(c) Card Ltd. is engaged in the business of manufacturing of car locks and nut bolts.

Car Locks: *Typically, a contract is entered into for sale of car locks and consideration is received in the event of delivery of goods to the customer place. The cost of each car lock is ₹ 1,500 and the selling price is ₹ 1,800. The terms of the contract entitles the customer to return any unused car locks within 30 days and receive a full refund. The Company estimates that the costs of recovering the car lock will be immaterial and expects that the returned car locks can be resold at a profit. The Company has sold a total of 20,000 car locks during the month ended 31st March, 2022. From past experience, Card Ltd. expects that 4% of the car locks will be returned in the financial year 2022 - 2023.*

Nut Bolts: *On 1st April, 2021, Card Ltd. enters into a one year contract with a customer to deliver nut bolts. The contract stipulates that the price per piece will be adjusted retrospectively once the customer reaches certain sales volume, defined, as follows:*

Price per piece	*Cumulative sales volume*
₹ 200	*1 – 50,000*
₹ 190	*50,001 – 1,00,000*
₹ 180	*1,00,001 & above*

Volume is determined based on sales during the financial year. There are no minimum purchase requirements. Card Ltd. estimates that the total sales volume for the year will be 90,000 based on its experience with similar contracts and forecasted sales to the customer.

Card Ltd. sells 24,000 pieces to the customer during the first quarter of the financial year 2021-2022 for a contract price of ₹ 200 per piece.

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You are required to:

(i) Analyze the terms of the revenue contracts with customers for sale of car locks as per Ind AS 115. Determine the amount of revenue, refund liability and the asset to be recognized by Card Ltd. for the said contracts of car locks.

(ii) Determine the transaction price, revenue and liability, if any, for nut bolts as per Ind AS 115 at the end of first quarter of the financial year 2021-2022. ***(8 Marks)***

Answer

(a) (i) A company which meets the net worth, turnover or net profits criteria in immediately preceding financial year will need to constitute a CSR Committee and comply with provisions of sections 135(2) to (5) read with the CSR Rules.

As per the criteria to constitute CSR committee -

(1) Net worth greater than or equal to ₹ 500 Crore: This criterion is not satisfied.

(2) Sales greater than or equal to ₹ 1000 Crore: This criterion is not satisfied.

(3) Net profit greater than or equal to ₹ 5 crore: The net profit for the immediately preceding financial year ended 31st March, 2021 is ₹ 7.75 crore. Hence, this criterion is satisfied.

Therefore, PK Ltd. will be required to form a CSR committee.

However, sub-section (9) of section 135 of the Companies Act, 2013 provides that if the amount to be spent as CSR expenditure is less than fifty lakh rupees, the requirement of forming a CSR committee will not be applicable and the functions of CSR committee will be discharged by the Board of Directors. In the given case, as the company is required to spend 10.66 lacs being 2% of average net profits ₹ 5.33 crore [(7.75 + 4.25+4)/3], the company need not form the CSR committee.

(ii) The company is obligated to spend a sum of ₹ 1,50,000 by contributing the same to 'Save Water Foundation'; hence, ₹ 1,50,000 shall qualify as CSR expenditure. Since only 50% has been paid to the Foundation, the company will be required to make provision of balance 50% in the books of accounts. It is immaterial whether the company determines the amount of contribution based on sale of product.

Note: The above solution has been provided on integrated reading of the scenario given in the question.

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(b) INDENTIFIACTION OF OBLIGATIONS:

ANANDAM Ltd. has made sale of two goods – machine and space parts, whose control is transferred at a point in time. Additionally, company agrees to hold the spare parts for the customer for a period of 1-3 years, which is a separate performance obligation. Therefore, total transaction price shall be allocated amongst 3 performance obligations viz

(i) Sale of machinery

(ii) Sale of spare parts

(iii) Custodial services for storing spare parts.

RECOGNITION OF REVENUE:

Recognition of revenue for each of the three performance obligations shall occur as follows:

(i) Sale of machinery: Machine has been sold to the customer and physical possession as well as legal title passed to the customer on 31st March, 2022. Accordingly, revenue for sale of machinery shall be recognised on 31st March, 2022.

(ii) Sale of spare parts: The customer has made payment for the spare parts and legal title has been passed to specifically identified goods, but such spares continue to be physically held by the entity. In this regard, the company shall evaluate if revenue can be recognized on bill-and-hold basis if **all** below criteria are met:

(a)	The reason for the bill-and-hold arrangement must be substantive (for example, the customer has requested the arrangement);	The customer has specifically requested the entity to store goods in their warehouse, owing to proximity to customer's factory.
(b)	The product must be identified separately as belonging to the customer;	The spare parts have been specifically identified and inspected by the customer.
(c)	The product currently must be ready for physical transfer to the customer; and	The spares are identified and segregated, therefore, ready for delivery any time.
(d)	The entity cannot have the ability to use the product or to direct it to another customer	Spares have been segregated and cannot be redirected to any other customer.

Therefore, **all** the above conditions of bill-and-hold are met and hence, company can recognize revenue for sale of spare parts on 31st March, 2022.

(iii) **Custodial services:** Such services shall be given for a period of 1 to 3 years from 31st March, 2022. Where services are given uniformly and customer receives &

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consumes benefits simultaneously, revenue for such service shall be recognized on a straight-line basis over a period of time.

(c) Analysis:

(i) (a) Nature of consideration received:

Card Ltd. applies the requirements in Ind AS 115 to the portfolio of 20,000 car locks because it reasonably expects that the effects on the financial statements from applying the requirements to the portfolio would not differ materially from applying the requirements to the individual contracts within the portfolio. Since the contract allows a customer to return the products, the consideration received from the customer is variable.

(b) Probability of significant reversal of cumulative revenue:

Card Ltd. considers on constraining estimates of variable consideration to determine whether the estimated amount of variable consideration of ₹ 3,45,60,000 (₹ 1,800 x 19,200 car locks not expected to be returned) can be included in the transaction price. Card Ltd. determines that although the returns are outside the entity's influence, it has significant experience in estimating returns for this product and customer class. In addition, the uncertainty will be resolved within a short time frame ie the 30-day return period. Thus, Card Ltd. concludes that it is highly probable that a significant reversal in the cumulative amount of revenue recognised (i.e. ₹ 3,45,60,000) will not occur as the uncertainty will be resolved (i.e. over the return period).

Card Ltd. estimates that the costs of recovering the products will be immaterial and expects that the returned products can be resold at a profit.

Upon transfer of control of the 20,000 car locks, Card Ltd. does not recognise revenue for 800 car locks that it expects to be returned. Consequently, it recognises the following:

(a) revenue of ₹ 3,45,60,000 (₹ 1,800 x 19,200 products not expected to be returned);

(b) a refund liability of ₹ 14,40,000 (₹ 1,800 refund x 800 products expected to be returned); and

(c) an asset of ₹ 12,00,000 (₹ 1,500 x 800 products for its right to recover products from customers on settling the refund liability).

(ii) (a) Transaction Price: The transaction price will be based on Card Ltd.'s estimate of total sales volume for the year. Since Card Ltd. estimates cumulative sales volume of 90,000 nut bolts during the year, transaction price per nut bolt will be ₹ 190. Card Ltd. will update its estimate of the total sales volume at each reporting date until the uncertainty is resolved.

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(b) Determination of Revenue: Card Ltd. concludes that based on a transaction price of ₹ 190 per nut bolt, it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty is resolved. Revenue is therefore recognised at a selling price of ₹ 190 per nut bolt as each nut bolt is sold. Accordingly, for the first quarter of the financial year 2021-2022, Card Ltd. recognizes revenue of ₹ 45,60,000 (24,000 nut bolts x ₹ 190).

(c) Determination of Liability: Card Ltd. will recognise a liability for cash received in excess of the transaction price for the first 50,000 nut bolts sold at ₹ 200 per nut bolt (that is, ₹ 10 per nut bolt) until the cumulative sales volume is reached for the next pricing tier and the price is retroactively reduced. Accordingly, for the first quarter of the financial year 2021-2022, Card Ltd. recognizes liability of ₹ 2,40,000 (24,000 nut bolts x (₹ 200 – ₹ 190).

Question 3

(a) On 1st April, 2021, the fair value of the assets of Raj Ltd.'s defined benefit plan were valued at ₹ 20,40,000 and the present value of the defined obligation was ₹ 21,25,000. On 31st March, 2022, the plan received contributions from Raj Ltd. amounting to ₹ 4,75,000 and paid out benefits of ₹ 2,65,000. The current service cost for the financial year ending 31st March, 2022 is ₹ 5,10,000. An interest rate of 5% per annum is to be applied to the plan assets and obligations. The fair value of the plan assets at 31st March, 2022 was ₹ 23,90,000, and the present value of the defined benefit obligation was ₹ 27,20,000.

Provide a reconciliation from the opening balance to the closing balance for Plan assets and Defined benefit obligation. Also show how much amount should be recognized in the statement of profit and loss, other comprehensive income and balance sheet?

(7 Marks)

(b) Zera Limited obtained a term loan of ₹ 1,080 lakh for complete renovation and modernization of its factory on 1st April, 2021. Plant and Machinery was acquired under the modernization scheme and installation was completed on 30th April, 2022. An expenditure of ₹ 910 lacs was incurred on installation of Plant and Machinery and the balance loan was used for working capital purposes. Management of Zera Limited considers the 12 months period as substantial period of time to get the asset ready for its intended use.

The company has paid total interest of ₹ 94.40 lacs during financial year 2021-2022 on the above loan.

Discuss the treatment in the books of account of Zera Limited of interest paid of ₹ 94.40 lakh during the financial year 2021-2022.

Will your answer be different, if the whole process of renovation and modernization gets completed by 31st December, 2021? ***(7 Marks)***

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(c) GEM Ltd., an Indian company acquired 75% of the share capital of VEW Ltd. on 30th September, 2020, an entity registered as company in USA. The functional currency of GEM Ltd. is Rupees and its financial year end on 31st March, 2021. The functional currency of VEW Ltd. is USD.

(i) On 30th September, 2020, the fair value of the Net Assets of VEW Ltd. was USD 10 million and the purchase consideration paid was USD 7.8 million. The exchange rate as at 30th September, 2020 was ₹ 71.5 per USD and at 31st March, 2021 was ₹ 73.5 per USD.

(ii) VEW Ltd. sold goods costing USD 1.9 million to GEM Ltd. for USD 3.1 million during the year ended 31st March, 2021. The exchange rate on the date of purchase by GEM Ltd. was ₹ 70.5 per USD and on 31st March, 2021 was ₹ 73.5 per USD. 50% of the goods purchased by GEM Ltd. from VEW Ltd. were unsold as at 31st March, 2021.

For (i) determine the value at which the Goodwill should be recognized in the financial statements of GEM Ltd. as at 31st March, 2021.

For (ii) determine the unrealized profit to be eliminated in the preparation of consolidated financial statements of GEM Ltd. for the year ending on 31st March, 2021. ***(6 Marks)***

Answer

(a) Reconciliation of Plan assets and Defined benefit obligation

	Plan Assets ₹	Defined benefit obligation ₹
Fair value/present value as at 1st April, 2021	20,40,000	21,25,000
Interest @ 5%	1,02,000	1,06,250
Current service cost		5,10,000
Contributions received	4,75,000	-
Benefits paid	(2,65,000)	(2,65,000)
Return on gain (assets) (balancing figure)	38,000	-
Actuarial Loss (balancing figure)	-	2,43,750
Closing balance as at 31st March, 2022	23,90,000	27,20,000

In the Statement of Profit and Loss, followings will be recognised:

	₹
Current service cost	5,10,000
Net interest on net defined liability (₹ 1,06,250 – ₹ 1,02,000)	4,250

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In Other Comprehensive Income, following Defined Benefits re-measurements will be recognised:

	₹
Loss on defined benefit obligation	(2,43,750)
Gain on plan assets	38,000
	(2,05,750)

In the Balance Sheet, following Net Defined Liability will be recognised:

	₹
Net defined liability (₹ 27,20,000 – ₹ 23,90,000)	3,30,000

(b) Treatment procedure:

As per Ind AS 23, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset. Other borrowing costs are recognised as an expense.

Where, a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

Applicability to the given case:

Accordingly, the treatment of interest of ₹ 94.40 lakh occurred during the year 2021-2022 would be as follows:

(i) When construction of asset completed on 30th April, 2022

The treatment for total borrowing cost of ₹ 94.40 lakh will be as follows:

Purpose	Nature	Interest to be capitalised ₹ in lakh	Interest to be charged to profit and loss account ₹ in lakh
Modernisation and renovation of plant and machinery	Qualifying asset	[94.40 x (910/1,080)] = 79.54	
Working Capital	Not a qualifying asset		[94.40 x (170/1,080)] = 14.86
		79.54	14.86

(ii) When construction of assets is completed by 31st December, 2021

When the process of renovation gets completed in less than 12 months, the plant and machinery will not be considered as a qualifying asset until and unless the

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entity specifically considers that the asset took substantial period for completing its construction.

Accordingly, the whole of interest will be charged off to Profit and Loss account.

(c) (i) Para 47 of Ind AS 21 requires that goodwill arose on business combination shall be expressed in the functional currency of the foreign operation and shall be translated at the closing rate in accordance with paragraphs 39 and 42.

When NCI is measured at proportionate share of net assets, the amount of goodwill will be as follows:

Net identifiable asset	Dr.	USD 10 million	
Goodwill (bal. fig.)	Dr.	USD 0.30 million	
To Bank (Purchase consideration)			USD 7.80 million
To NCI (10 x 25%)			USD 2.50 million

Thus, goodwill on reporting date in the books of GEM Ltd. would be

= USD 0.30 million x ₹ 73.50 = ₹ 22.05 million

Alternatively, when NCI is measured at fair value, the amount of goodwill will be as follows:

Net identifiable asset	Dr.	USD 10 million	
Goodwill (bal. fig.)	Dr.	USD 0.40 million	
To Bank (Purchase consideration)			USD 7.80 million
To NCI (7.8/75*25)			USD 2.60 million

Thus, goodwill on reporting date in the books of GEM Ltd. would be

= USD 0.40 million x ₹ 73.50 = ₹ 29.40 million

(ii) Calculation of unrealised profit

Particulars	**USD in million**
Sale price of inventory	3.10
Cost of inventory	1.90
Profit earned by VEW Ltd.	1.20
Unrealised profit (1.20 x 50%) [a]	0.60

Exchange rate as on date of purchase of inventory [b] ₹ 70.50 / USD

Unrealized profit to be eliminated [a x b] = USD 0.60 million x ₹ 70.50

= ₹ 42.30 million

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As per para 39 of Ind AS 21, income and expenses for each statement of profit and loss presented (ie including comparatives) shall be translated at exchange rates at the dates of the transactions.

In the given case, purchase of inventory is an expense item shown in the statement profit and loss. Hence, the exchange rate on the date of purchase of inventory is taken for calculation of unrealized profit which is to be eliminated while preparation of consolidated financial statements.

Question 4

(a) *X Ltd. issues ₹ 1.5 crore convertible bonds on 1st April, 2018. The bonds have a life of 8 years and a face value of ₹ 10 each and offer interest @ 5.5% p.a. payable at the end of each financial year.*

Bonds are issued at their face value and each bond can be converted into one ordinary share of X Ltd. at any time in the next eight years.

Companies of a similar risk profile have recently issued debt with similar terms, without the option for conversion, at a rate of 7% p.a.

You are required to:

(i) *Provide the journal entries from financial year 2018-2019 to financial year 2021-2022;*

(ii) *Calculate the interest expenses across all eight years of the life of the convertible bonds;*

(iii) *Give the accounting entries if the holders of the bonds elect to convert the bonds to ordinary shares at the end of the fourth year (after receiving interest for the fourth year).* ***(14 Marks)***

(b) *Discuss the following in the context of 'Conceptual Framework for Financial Reporting under Indian Accounting Standards':*

(i) *The cost constraint on useful financial information*

(ii) *Executory contracts.*

OR

What is Integrated Reporting? Discuss any 5 salient features of Integrated Reporting Framework. ***(6 Marks)***

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Answer

(a) (i) Journal Entries

		Dr. (₹)	Cr. (₹)
1st April, 2018			
Bank A/c	Dr.	1,50,00,000	
To Convertible bonds A/c (liability) (Refer W.N.)			1,36,56,075
To Convertible bonds A/c (equity) (Refer W.N.)			13,43,925
(Being recognition of convertible bonds at the date of issuance into liability and equity components)			
31st March, 2019			
Interest expense A/c	Dr.	9,55,925	
To Bank A/c			8,25,000
To Convertible bonds A/c (liability)			1,30,925
(Being interest expense recorded at market rate of 7% and actual interest paid @ 5.5%)			
31st March, 2020			
Interest expense A/c	Dr.	9,65,090	
To Bank A/c			8,25,000
To Convertible bonds A/c (liability)			1,40,090
(Being interest expense recorded at market rate of 7% and actual interest paid @ 5.5%)			
31st March, 2021			
Interest expense A/c	Dr.	9,74,896	
To Bank A/c			8,25,000
To Convertible bonds A/c (liability)			1,49,896
(Being interest expense recorded at market rate of 7% and actual interest paid @ 5.5%)			
31st March, 2022			
Interest expense A/c	Dr.	9,85,389	
To Bank A/c			8,25,000
To Convertible bonds A/c (liability)			1,60,389
(Being interest expense recorded at market rate of 7% and actual interest paid @ 5.5%)			

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(ii) Table showing computation of interest expense at market rate and actual interest outflow @ 5.5%

Year	Date	Opening bond liability	Actual interest outflow @ 5.5%	Interest expense @ 7%	Increase in liability	Closing bond liability
		a	b =1.5 cr x 5.5%	c = a x 7%	d = c-b	e = a+d
0	1st April, 2018					1,36,56,075
1	31st March, 2019	1,36,56,075	8,25,000	9,55,925	1,30,925	1,37,87,000
2	31st March, 2020	1,37,87,000	8,25,000	9,65,090	1,40,090	1,39,27,090
3	31st March, 2021	1,39,27,090	8,25,000	9,74,896	1,49,896	1,40,76,986
4	31st March, 2022	1,40,76,986	8,25,000	9,85,389	1,60,389	1,42,37,375
5	31st March, 2023	1,42,37,375	8,25,000	9,96,616	1,71,616	1,44,08,991
6	31st March, 2024	1,44,08,991	8,25,000	10,08,629	1,83,629	1,45,92,620
7	31st March, 2025	1,45,92,620	8,25,000	10,21,483	1,96,483	1,47,89,103
8	31st March, 2026	1,47,89,103	8,25,000	10,35,897*	2,10,897	1,50,00,000

*Difference of ₹ 660 (10,35,897 -10,35,237) is due to rounding off

(iii) When holders of the bonds elect to convert the bonds to ordinary shares at the end of the fourth year (after receiving their interest payments), the entries would be:

		Dr. (₹)	Cr. (₹)
31st March, 2022			
Convertible bonds A/c (liability)	Dr.	1,42,37,375	
Convertible bonds A/c (equity)	Dr.	13,43,925	
To Ordinary share capital A/c			1,55,81,300
(Being bonds converted into ordinary shares of X Ltd.)			

Working Note:

Computation of equity and liability component of convertible bond at 7% market rate

	₹
Present value of principal to be received at the end of eight year discounted at 7% (1,50,00,000 x 0.582)	87,30,000

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Annuity of annual interest discounted at 7% for 8 years (1,50,00,000 x 5.5% x 5.971)	49,26,075
Total present value (a)	1,36,56,075
Equity component (balancing figure) (a-b)	13,43,925
Total proceeds received from issuance of convertible bonds (b)	1,50,00,000

(b) EITHER

(i) The cost constraint on useful financial information;

Role of Cost: Cost is a pervasive constraint on the information that can be provided by financial reporting. Reporting financial information imposes costs, and it is important that these costs are justified by the benefits of reporting that information.

Basis of Assessment of Cost: Both the providers and users of financial information incur costs in reporting and analysing financial information. In applying the cost constraint, ICAI assesses whether the benefits of reporting particular information are likely to justify the costs incurred to provide and use that information. When applying the cost constraint in formulating a proposed Ind AS, the ICAI seeks information from providers of financial information, users, auditors, academics and others about the expected nature and quantity of the benefits and costs of that Ind AS. In most situations, assessments are based on a combination of quantitative and qualitative information.

Cost Perspective: Due to the inherent subjectivity, assessments of different individuals about the costs and benefits of reporting particular items of financial information will vary. Therefore, ICAI seeks to consider costs and benefits in relation to financial reporting generally, and not just in relation to individual reporting entities.

(ii) Executory Contracts:

Definition: An executory contract is a contract, or a portion of a contract, that is equally unperformed — neither party has fulfilled any of its obligations, or both parties have partially fulfilled their obligations to an equal extent.

Outcome of Executory Contract: An executory contract establishes a combined right and obligation to exchange economic resources. The rights and obligations are inter-dependent and cannot be separated. Hence, the combined rights and obligations constitute a single asset or liability.

The entity has an asset if the terms of the exchange are currently favourable; it has a liability if the terms of the exchange are currently unfavourable.

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Basis of Disclosure: Whether such an asset or liability is included in the financial statements depends on both the recognition criteria and the measurement basis selected for the asset or liability, including, if applicable, any test for whether the contract is onerous.

OR

Definition: Integrated reporting is a concept that has been created to better articulate the broader range of measures that contribute to long-term value and the role organizations play in society. Integrated Reporting is enhancing the way organizations think, plan and report the story of their business. Central to this is the proposition that value is increasingly shaped by factors additional to financial performance, such as reliance on the environment, social reputation, human capital skills and others.

The five salient features of Integrated Reporting Framework are as follows:

1. **Principle Based Approach:** This Framework identifies information to be included in an integrated report for use in assessing an organization's ability to create value. It does not set benchmarks for such things as the quality of an organization's strategy or the level of its performance.
2. **Targets the Private Sector or Profit-making Companies:** This Framework is written primarily in the context of private sector, for-profit companies of any size but it can also be applied, adapted as necessary, by public sector and not-for-profit organizations.
3. **Identifiable Communication:** An integrated report may be prepared in response to existing compliance requirements and may be either a standalone report or be included as a distinguishable, prominent and accessible part of another report or communication. An integrated report is intended to be more than a summary of information in other communications (e.g., financial statements, a sustainability report, analyst calls, or on a website); rather, it makes explicit the connectivity of information to communicate how value is created over time.
4. **Financial and Non-financial Items:** The primary purpose of an integrated report is to explain to providers of financial capital how an organization creates value over time. It, therefore, contains relevant information, both financial and other.
5. **Value Creation:** Value created by an organization over time manifests itself in increases, decreases or transformations of the capitals caused by the organization's business activities and outputs. That value has two interrelated aspects – value created for:

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- The organization itself, which enables financial returns to the providers of financial capital
- Others (i.e., stakeholders and society at large)

Question 5

(a) Shagun Ltd. received two different grants from State Government as per details below:

(i) A cash grant of ₹ 24 lakh was received on 31st March, 2020 towards the skill development of employees over a period of 18 months, starting from 1st April, 2020. Actual costs of the skill development program in financial year 2020-2021 was ₹ 30 lakh and in financial year 2021-2022 was ₹ 20 lakh.

State, how this grant should be accounted for in the books of account in financial year 2019-2020, 2020-2021 & 2021-2022?

(ii) A grant of ₹ 10 lakh receivable over three years (₹ 5 lakh in financial year 2019-2020, ₹ 2 lakh in financial year 2020-2021 and ₹ 3 lakh in financial year 2021-2022), contingent on developing 5 gardens and maintaining them for three years. The gardens are developed in financial year 2019-2020 at a total cost of ₹ 6 lakh, and the maintenance cost for financial year 2019-2020 is ₹ 12 lakh, for financial year 2020-2021 is ₹ 15 lakh and for financial year 2021-2022 is ₹ 17 lakh.

Calculate the grant income and deferred income to be accounted for in the books for financial years 2019-2020, 2020-2021 & 2021-2022. ***(8 Marks)***

(b) Black Ltd. is a manufacturing company. The following balances as at 31st March, 2021 are from the audited Financial Statements and as at 30th September, 2021 & 31st March, 2022 are provided by the accountant of Black Ltd:

Asset / (Liability)	*Carrying Amount as at (₹ in lakh)*		
	31.3.2021	*30.9.2021*	*31.3.2022*
Attributed goodwill	*2,560*	*2,560*	
Intangible assets	*12,680*	*11,080*	
Financial assets measured at Fair Value through Other Comprehensive Income (FVTOCI)	*4,310*	*5,260*	*7,310*
Property, plant & equipment	*16,820*	*18,670*	
Deferred tax assets	*3,120*	*3,120*	*2,970*
Current assets: inventory, receivables, cash & cash equivalents	*8,640*	*7,040*	*4,860*

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Current liabilities	*(11,110)*	*(13,230)*	*(16,190)*
Non-current liabilities: Provisions	*(3,670)*	*(4,610)*	*(4,610)*
Total	*33,350*	*29,890*	*(5,660)*

Black Ltd. decided to sell the business on 30th September, 2021. The business meets the condition of disposal group classified as held for sale on that date in accordance with Ind AS 105. However, it does not meet the conditions to be classified as discontinued operations in accordance with Ind AS 105. Black Ltd. proposed to sell the disposal group at ₹ 26,000 lakh. The costs to sell is estimated at ₹ 200 lakh.

As at 31st March, 2022, there has been no change to the plan to sell the disposal group and Black Ltd. still expects to sell it within one year of initial classification. The disposal group has not been trading well and its fair value less costs to sell has fallen to ₹ 19,738 lakh.

You are asked to calculate the value of all assets / liabilities within the disposal group as at 30th September, 2021 and 31st March, 2022 in accordance with Ind AS 105.

(8 Marks)

(c) *GOLD Ltd., a manufacturing company, prepares its financial statements on 31st March every year. On 1st April, 2021, it had issued (a) 10,00,000 ordinary shares and (b) 6% convertible bonds amounting to ₹ 1,00,000, the terms of conversion being 120 ordinary shares for every ₹ 100. On 30th June, 2021, ₹ 50,000 bonds converted to ordinary shares. The profit for the year ended 31st March, 2022 is ₹ 2,50,000. The applicable tax rate is 25%.*

Calculate basic and diluted EPS. Ignore the need to split the convertible bonds into liability and equity element. ***(4 Marks)***

Answer

(a) (i) At 31st March, 2020 the grant would be recognised as a liability and presented in the balance sheet as a split between current and non-current amounts.

₹ 16 lakh [(12 months / 18 month) x 24 lakh] is current and would be recognised in profit and loss for the year ended 31st March, 2021. The balance amount of ₹ 8 lakh will be shown as non-current.

At the end of the year 2020-2021, there would be a current balance of ₹ 8 lakh (being the non-current balance at the end of year 2019-2020 reclassified as current) in the balance sheet. This would be recognised as profit in the statement of profit and loss for the year ended on 2021-2022.

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Balance Sheet (extracts) as at

	31st March,2020	31st March,2021	31st March,2022
Current liabilities			
Deferred income	16 lakh	8 lakh	-
Non-current liabilities			
Deferred income	8 lakh	-	-

Statement of Profit and Loss (extracts) for the year ended

	31st March, 2021	31st March, 2022
Method 1 (As per para 29 of Ind AS 20)		
Other Income - Government grant received	16 lakh	8 lakh
Training costs	(30 lakh)	(20 lakh)
Method 2 (Alternative) (As per para 29 of Ind AS 20)		
Training costs (30 lakh – 16 lakh)	14 lakh	
Training costs (20 lakh – 8 lakh)		12 lakh

(ii) The income of ₹ 10 lakh should be recognised over the three-year period to compensate for the related costs. Since the receipt of grant is depending on fulfilling the contract, it is assumed that on initial date certainty to fulfil the conditions by the entity could not be established. Hence, the grant is recognised in the books on receipt basis.

Calculation of Grant Income and Deferred Income: **(₹ in lakh)**

Year	Maintenance Cost	Grant Income	Grant received during the year	Deferred Income
	a	b = [(10/50) x a]	c	d
2019-2020	18	3.6	5	(5 – 3.6)1.4
2020-2021	15	3.0	2	[(5 + 2) – (3.6 + 3.0)] 0.4
2021-2022	17	3.4	3	[(5 + 2 + 3) – (3.6+ 3.0 + 3.4)] –
	50	10.0		

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Therefore, Grant income to be recognised in Profit & Loss for years 2019-2020, 2020-2021 and 2021-2022 will be ₹ 3.6 lakh, ₹ 3.0 lakh and ₹ 3.4 lakh respectively.

Amount of grant that has not yet been credited to profit & loss i.e. deferred income will be reflected in the balance sheet. Hence, deferred income balance as at year end 2019-2020, 2020-2021 and 2021-2022 will be ₹ 1.4 lakh, ₹ 0.4 lakh and Nil respectively.

(b) (i) As at 30th September, 2021

The disposal group should be measured at ₹ 25,800 lakh (₹ 26,000 lakh - ₹ 200 lakh). The impairment write down of ₹ 4,090 lakh (₹ 29,890 lakh – ₹ 25,800 lakh) should be recorded within profit from continuing operations.

The impairment of ₹ 4,090 should be allocated to the carrying values of the appropriate non-current assets.

Asset / (liability)	Carrying value as at 30th September, 2021	Impairment	Revised carrying value as per Ind AS 105
Attributed goodwill	2,560	(2,560)	-
Intangible assets	11,080	(570)*	10,510
Financial asset measured at fair value through other comprehensive income	5,260	-	5,260
Property, plant & equipment	18,670	(960)**	17,710
Deferred tax asset	3,120	-	3,120
Current assets – inventory, receivables and cash balances	7,040	-	7,040
Current liabilities	(13,230)	-	(13,230)
Non-current liabilities – provisions	(4,610)	-	(4,610)
Total	29,890	(4,090)	25,800

*[(4,090 – 2,560) x {11,080/(11,080 + 18,670)}]

**[(4,090 – 2,560) x {18,670/(11,080 + 18,670)}]

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The impairment loss is allocated first to goodwill and then pro-rata to the other assets of the disposal group within Ind AS 105 measurement scope. Following assets are not in the measurement scope of this standard- financial asset measured at other comprehensive income, the deferred tax asset or the current assets. In addition, the impairment allocation can only be made against assets and is not allocated to liabilities.

(ii) As on 31st March, 2022

All the assets and liabilities, outside the scope of measurement under Ind AS 105, are remeasured in accordance with the relevant standards. The assets that are remeasured in this case under the relevant standards are the financial asset measured at fair value through other comprehensive income (Ind AS 109), the deferred tax asset (Ind AS 12), the current assets and liabilities (various standards) and the non-current liabilities (Ind AS 37).

Asset / (liability)	Carrying amount as on 30th September, 2021	Change in value to 31st March, 2022	Impairment	Revised carrying value as per Ind AS 105
Attributed goodwill	-	-	-	-
Intangible assets	10,510	-	(1,051)*	9,459
Financial asset measured at fair value through other comprehensive income	5,260	2,050	-	7,310
Property, plant & equipment	17,710	-	(1,771)**	15,939
Deferred tax asset	3,120	(150)	-	2,970
Current assets – inventory, receivables and cash balances	7,040	(2,180)	-	4,860
Current liabilities	(13,230)	(2,960)	-	(16,190)
Non-current liabilities – provisions	(4,610)	-	-	(4,610)
Total	25,800	(3,240)	(2822)	19,738

*[2,822 x {10,510 /(10,510 + 17,710)}]

**[2,822 x {17,710 /(10,510 + 17,710)}]

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(c)

	Number of shares	Profit (₹)
Profit		2,50,000
Outstanding ordinary shares	10,00,000	
New shares on conversion (weighted average) [(9/12 x ₹ 50,000 / 100 x 120)]	45,000	
Figures for basic EPS	10,45,000	2,50,000
Basic EPS is (₹ 2,50,000 / 10,45,000 shares) = ₹ 0.239 per share		
Dilution adjustments		
Unconverted shares (₹ 50,000 / 100 x 120)	60,000	
Interest (₹ 50,000 x 6% x 0.75 net of tax)		2,250
Converted shares pre conversion adjustment (3/12 x ₹ 50,000 / 100 x 120)	15,000	
Interest: [3/12 x ₹ 50,000 x 6% x 0.75 net of tax]		562.50
	11,20,000	2,52,812.50
Diluted EPS is (₹ 2,52,812.50 / 11,20,000 shares) = ₹ 0.226 per share		

Question 6

(a) Shravan Ltd. owns 6,800 ordinary shares in PQR Ltd., an unquoted company. PQR Ltd. has a total share capital of 2,00,000 shares with nominal value of ₹ 10. PQR Ltd.'s after tax maintainable profits are estimated at ₹ 28,00,000 per year. An appropriate price/earnings ratio determined from published industry data is 12 (before lack of marketability adjustment). Shravan Ltd.'s management estimates that the discount for the lack of marketability of PQR Ltd.'s shares and restrictions on their transfer is 18%.

Shravan Ltd. values its holding in PQR Ltd.'s shares based on earnings.

Determine the fair value of Shravan Ltd.'s investment in PQR Ltd.'s shares. ***(5 Marks)***

(b) X Ltd. has made a borrowing from RGD Bank for ₹ 20,000 at a fixed interest of 12% per annum. Loan processing fees were paid additionally amounting to ₹ 1,000 and the loan is payable in 4 half-yearly installments of ₹ 5,000 each.

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Details are as follows:

Particulars	*Details*
Loan amount	*₹ 20,000*
Date of loan (Starting Date)	*1st April, 2020*
Date of loan (Finishing Date)	*31st March, 2022*
Description of repayment	*Repayment of loan starts from 30th September, 2020 (To be paid on half yearly basis)*
Installment amount	*₹ 5,000*
Interest rate	*12% per annum*
Interest charge	*Interest to be charged and paid quarterly*
Upfront fees	*₹ 1,000*

Compute the interest to be charged to the statement of profit & loss every quarter over the period of loan. The effective interest rate is 16.60% per annum. ***(5 Marks)***

(c) *F Ltd. owned a land property whose future use was not determined as at 31st March, 2021. How should the property be classified in the books of F Ltd. as at 31st March, 2021?*

During June 2021, F Ltd. commenced construction of office building on it for own use. Presuming that the construction of the office building is still in progress as at 31st March, 2022.

(i) *How should the land property be classified by F Ltd. in its financial statements as at 31st March, 2022?*

(ii) *Will there be a change in the carrying amount of the property resulting from any change in use of the investment property?*

(iii) *Whether the change in classification to, or from, investment properties is a change in accounting policy to be accounted for in accordance with Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors?*

(iv) *Would your answer to (i) above be different if there were to be a management intention to commence construction of an office building for own use; however, no construction activity was planned by 31st March, 2022?* ***(5 Marks)***

(d) *RST Ltd. prepares consolidated financial statements as at 31st March each year. On 1st July, 2021, RST Ltd. acquired 75% of the equity shares of DHF Ltd. and gained control of DHF Ltd. The issued shares of DHF Ltd. are 1,20,00,000 equity shares. Details of the purchase consideration are as follows:*

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On 1st July 2021, RST Ltd. issued two shares for every three shares acquired in DHF Ltd. On 1st July 2021, the market value of an equity share in RST Ltd. was ₹ 6.50 and the market value of an equity share in DHF Ltd. was ₹ 5.50.

On 30th June 2022, RST Ltd. will make cash payment of ₹ 71,50,000 to the former shareholders of DHF Ltd. who sold their shares to RST Ltd. on 1st July 2021. On 1st July, 2021, RST Ltd. would have to pay interest at an annual rate of 10% on borrowings.

On 30th June 2023, RST Ltd. may make a cash payment of ₹ 3,00,00,000 to the former shareholders of DHF Ltd. who sold their shares to RST Ltd. on 1st July 2021. This payment is contingent upon the revenues of RST Ltd. growing by 15% over the two-year period from 1st July, 2021 to 30th June, 2023. On 1st July 2021, the fair value of this contingent consideration was ₹ 2,50,00,000. On 31st March 2022, the fair value of the contingent consideration was ₹ 2,20,00,000.

On 1st July 2021, the carrying values of the identifiable net assets of DHF Ltd. in the books of that company was ₹ 6,00,00,000. On 1st July 2021, the fair values of these net assets was ₹ 7,00,00,000. The rate of deferred tax to apply to temporary differences is 20%.

During the nine months ended on 31st March 2022, DHF Ltd. had a poorer than expected operating performance. Therefore, on 31st March, 2022 it was necessary for RST Ltd. to recognize an impairment of the goodwill arising on acquisition of DHF Ltd. amounting to 12.50% of its total computed value.

Compute the impairment of goodwill in the consolidated financial statements of RST Ltd. under the methods permitted by Ind AS 103 for the initial computation of the non-controlling interest in DHF Ltd. at the acquisition date. ***(5 Marks)***

Answer

(a) Calculation of an earnings-based valuation of Shravan Ltd.'s holding of shares in PQR Ltd.:

Particulars		Unit
PQR Ltd.'s after-tax maintainable profits	(A)	₹ 28,00,000
Price / Earnings ratio	(B)	12
Adjusted discount factor (1- 0.18)	(C)	0.82
Value of PQR Ltd.	(A) x (B) x (C)	₹ 2,75,52,000

Value of a share of PQR Ltd. = ₹ 2,75,52,000 / 2,00,000 shares = ₹ 137.76

The fair value of Shravan Ltd.'s investment in PQR Ltd.'s shares is estimated at ₹ 9,36,768 (that is, 6,800 shares × ₹ 137.76 per share).

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Alternative way of presentation:

Particulars		
PQR Ltd.'s after-tax maintainable profits in ₹	(A)	28,00,000
PQR Ltd.'s number of outstanding shares	(B)	2,00,000
PQR Ltd.'s EPS in ₹	(C = (A/B))	14.00
Industry PE ratio (given)	(D)	12
Market price of PQR Ltd. per share in ₹	(E = (C x D))	168.00
Discount for lack of marketability @ 18% in ₹	(F = E x 18%)	30.24
Adjusted price per share of PQR Ltd. in ₹	(G = (E-F))	137.76
Shravan Ltd.'s holding	(H)	6,800 shares
Fair value of Shravan's investment in PQR Ltd.	(G x H)	9,36,768.00

(b) The loan taken by X Ltd. shall be measured at amortised cost as follows:

Initial measurement = At transaction price less processing fee ie. ₹ 19,000 (20,000 – 1,000)

Subsequent measurement = Interest to be accrued using effective rate of interest as follows:

Quarter	Opening balance (A)	Interest @ 16.60% (B)=[(A) x 16.60%/4]	Cash flows (C) = [Refer column of D of W.N.]	Closing balance (A) + (B) - (C)
1	19,000.00	789.00	600.00	19,189.00
2	19,189.00	796.00	5,600.00	14,385.00
3	14,385.00	597.00	450.00	14,532.00
4	14,532.00	603.00	5,450.00	9,685.00
5	9,685.00	402.00	300.00	9,787.00
6	9,787.00	406.00	5,300.00	4,893.00
7	4,893.00	203.00	150.00	4,946.00
8	4,946.00	204.00*	5,150.00	-

* Difference is due to approximation.

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Working Note:

Quarter	Opening balance (A)	Interest @ 12% p.a. (B) = [(A) x 12%/4]	Principal repayment at quarter end (C)	Total Cash flow (D) = (B) + (C)	Closing balance (E) = (A) - (C)
1	20,000.00	600.00	-	600.00	20,000.00
2	20,000.00	600.00	5,000.00	5,600.00	15,000.00
3	15,000.00	450.00	-	450.00	15,000.00
4	15,000.00	450.00	5,000.00	5,450.00	10,000.00
5	10,000.00	300.00	-	300.00	10,000.00
6	10,000.00	300.00	5,000.00	5,300.00	5,000.00
7	5,000.00	150.00	-	150.00	5,000.00
8	5,000.00	150.00	5,000.00	5,150.00	-

(c) Treatment for the year ended 31.03.2021:

As per paragraph 8(b) of Ind AS 40, any land held for currently undetermined future use, should be classified as an investment property. Hence the land property should be classified by F Ltd. as an investment property in the financial statements as at 31st March, 2021.

Treatment for the year ended 31.03.2022:

I. Since F Ltd. has commenced construction of office building on it for own use, the property should be reclassified from investment property to owner occupied as at 31st March, 2022.

II. As per para 59 of the standard, transfers between investment property, owner occupied and inventories do not change the carrying amount of the property transferred and they do not change the cost of the property for measurement or disclosure purposes.

III. No, the change in classification to or from investment properties is due to change in use of the property. No retrospective application is required, and prior period's financial statements need not be restated.

IV. As per para 57 of the Standard, an entity can change the classification of any property to and from an investment property when and only when there is a change in use. A change in use occurs when the property meets or ceases to meet the definition of investment property and there is evidence of the change in use. Mere

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management's intention for use of the property does not provide evidence of a change in use.

Since F Ltd. has no plans to commence construction of the office building during 2021-2022, the property should continue to be classified as an investment property by F Ltd. in its financial statements as at 31st March, 2022.

(d) Computation of goodwill impairment

	NCI at fair value	NCI at proportionate share of net assets
	₹ in 000	₹ in 000
Cost of investment		
Share exchange (12,000 x 75% x 2/3 x ₹ 6.50)	39,000	39,000
Deferred consideration (7,150 / 1.10)	6,500	6,500
Contingent consideration	25,000	25,000
Total Purchase Consideration (a)	70,500	70,500
Non-controlling interest on the date of acquisition: (b)		
Fair value – 3,000 x ₹ 5.50	16,500	
% of net assets – 68,000 (Refer W.N.) x 25%		17,000
Net assets on the acquisition date (Refer W.N.) (c)	(68,000)	(68,000)
Goodwill on acquisition (a+b-c)	19,000	19,500
Impairment @ 12.50%	2,375.00	2,437.50

Working Note:

Net assets on the acquisition date	₹ in 000
Fair value at the acquisition date	70,000
Deferred tax on fair value adjustments [20% x (70,000 – 60,000)]	(2,000)
	68,000

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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) *M/s. Daksh Ltd is planning to import multipurpose machine from USA at a cost of $15000. The company can avail loans at 19% Interest per annum with quarterly rests with which it can import the machine.*

However, there is an offer from New York branch of an Indian based bank extending credit of 180 days at 2% per annum against opening of an irrevocable letter of credit.

Other Information:

Spot rate US$ 1 = ₹ 75

180 days forward rate US $ 1 = ₹ 77

Commission charges for letter of credit at 2% per 12 months.

(i) *Justify why the offer from the foreign branch should be accepted?*

(ii) *Based on the present market condition company is not interested to take the risk of currency fluctuations and wanted to hedge with an additional expenses of ₹ 30,000, if so, what is your advise to the company?*

Assume 360 days in the year. ***(8 Marks)***

(b) *You had purchased a 3 month call option on the Equity shares of Satya Ltd for a premium of ₹ 30 each, the current market price of the share is ₹ 560 and the exercise price is ₹ 590. You expect the price range between ₹ 540 to ₹ 640.*

The expected share price of Satya Ltd and related probability is given below:

Expected price (₹)	*540*	*560*	*580*	*600*	*620*	*640*
Probability	*0.10*	*0.15*	*0.05*	*0.35*	*0.20*	*0.15*

Compute the followings:

(i) *Expected share price at the end of 3 months,*

(ii) *Value of call option at the end of 3 months, if the exercise price prevails,*

(iii) *In case the option is held to its maturity, what will be the expected value of the call option?*

(iv) *Find out the price of the shares quoted at the stock exchange to get the value of the call option as computed in (iii) above.* ***(8 Marks)***

(c) *What is Net interest position risk and Price risk?* ***(4 Marks)***

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Answer

(a) (i) *Option I (To finance the purchases by availing loan at 19% per annum):*

	Amount
Cost of equipment ($ 15,000 at US$ 1 = ₹ 75)	₹ 11,25,000
Add: Interest at 4.75% I Quarter	53,438
Add: Interest at 4.75% II Quarter (on ₹ 11,78,438)	55,976
Total outflow in Rupees	12,34,414
Alternatively, interest may also be calculated on compounded basis, i.e.,	
₹ 1,12,5000 × $[1.0475]^2$	₹ 12,34,413

Option II (To accept the offer from foreign branch):

	Amount
Cost of letter of credit at 1 % on US$ 15,000 at US$ 1 = ₹ 75	₹ 11,250
Add: Interest for 180 days (₹ 11,250 × 19% x 180/360)	₹ 1,069
(A)	₹ 12,319
Payment at the end of 180 days:	
Cost	US$ 15,000
Interest at 2% p.a. [15000 × 2/100 × 180/360]	US$ 150
	US$ 15,150
Conversion at US$ 1 = ₹ 77 [15150 x ₹ 77] (B)	₹ 11,66,550
Total Cost: (A) + (B)	₹ 11,78,869

Advise: Option 2 is cheaper by (₹ 12,34,413 – ₹ 11,78,869) lakh or ₹ 55,544. Hence, the offer may be accepted.

(ii) If company is not interested to take the risk of currency fluctuations and wanted to hedge with an additional expense of ₹ 30,000 then it can do so because even taking forward position is resulting in increased cash outflow by the same amount.

(b) (i) Expected Share Price

= ₹ 540 X 0.10 + ₹ 560 X 0.15 + ₹ 580 X 0.05 + ₹ 600 X 0.35 + ₹ 620 X 0.20 + ₹ 640 X 0.15

= ₹ 54 + ₹ 84 + ₹ 29 + ₹ 210 + ₹ 124 + ₹ 96 = ₹ 597

(ii) Value of Call Option

= ₹ 590 - ₹ 590 = Nil

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(iii) If the option is held till maturity the expected Value of Call Option

Expected price (X)	Value of call (C)	Probability (P)	Expected Value of Option
₹ 540	0	0.10	0
₹ 560	0	0.15	0
₹ 580	0	0.05	0
₹ 600	₹ 10	0.35	₹ 3.50
₹ 620	₹ 30	0.20	₹ 6.00
₹ 640	₹ 50	0.15	₹ 7.50
Total			₹ 17.00

Alternatively, it can also be calculated as follows:

Expected price (X)	Exercise price (E)	Probability (P)	Expected Value of Option CP (X – E) X P
₹ 540	₹ 590	0.10	Not Exercised*
₹ 560	₹ 590	0.15	Not Exercised*
₹ 580	₹ 590	0.05	Not Exercised*
₹ 600	₹ 590	0.35	₹ 3.50
₹ 620	₹ 590	0.20	₹ 6.00
₹ 640	₹ 590	0.15	₹ 7.50
Total			₹ 17.00

* If the stock price goes below ₹ 590, option is not exercised at all.

(iv) Price to be quoted at the stock exchange to get the value of the call option

₹ 590 + ₹ 17 = ₹ 607

(c) **Net Interest Position Risk:** The size of non-paying liabilities is one of the significant factors contributing towards profitability of banks. Where banks have more earning assets than paying liabilities, interest rate risk arises when the market interest rates adjust downwards. Thus, banks with positive net interest positions will experience a reduction in NII as the market interest rate declines and increases when interest rate rises. Thus, large float is a natural hedge against the variations in interest rates.

Price Risk: Price risk occurs when assets are sold before their stated maturities. In the financial market, bond prices and yields are inversely related. The price risk is closely associated with the trading book, which is created for making profit out of short-term movements in interest rates.

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Banks which have an active trading book should, therefore, formulate policies to limit the portfolio size, holding period, duration, defeasance period, stop loss limits, marking to market, etc.

Question 2

(a) Mr. D had invested in three mutual funds (MF) as per the following details:

Particulars	***MF 'A'***	***MF 'B'***	***MF 'C'***
Amount of Investment	*2,00,000*	*5,00,000*	*4,00,000*
NAV at the time of purchase	*10.00*	*25.00*	*20.00*
Dividend Yield up to 31.03.2022	*3%*	*5%*	*4%*
NAV as on 31.03.2022	*10.50*	*22.80*	*20.80*
Annualized Yield as on 31.03.2022	*9.733%*	*- 11.185%*	*15%*

Assume 1 Year = 365 Days.

Mr. D has misplaced the documents of his investments.

You are required to help Mr. D to find out the following:

(i) Number of units allotted in each scheme,

(ii) Value of his investments as on 31.03.2022,

(iii) Holding period of his investments in number of days as on 31.03.2022

(iv) Dates of original investments

(v) Total Return on investments,

(vi) Assuming past performance of all three schemes will continue for next one year, what action the investor should take? What will be the expected return for the next one year after the above action?

(vii) Will your answer as above point no. (vi) changes if the Mutual fund charges exit load of 5% if the investment is redeemed within one year? If so, advise the investor what and when the action to be taken to optimise the returns. ***(8 Marks)***

(b) Calculate the value of share from the following Information:

Profit of the company (After tax)	*₹ 560 crores*
Equity share capital of the Company	*₹ 1900 crores*
Par value of share	*₹ 50 each*
Debt ratio (Debt/Debt + Equity)	*43%*
Long run growth rate of the company	*7%*
Beta 0.1 (Risk free Interest rate)	*9.5%*

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Market return	*12.6%*
Capital expenditure per share	*₹ 53*
Depreciation per share	*₹ 45*
Increase in working capital	*₹ 4.62 per share*

(8 Marks)

(c) Explain the outcomes of Financial Planning. ***(4 Marks)***

Answer

(a) (i) Number of Units in each Scheme

MF 'A'	₹ 2,00,000 / ₹ 10.00	= 20,000
MF 'B'	₹ 5,00,000 / ₹ 25.00	= 20,000
MF 'C'	₹ 4,00,000 / ₹ 20.00	= 20,000

(ii) Value of Investment on 31.03.2022

MF 'A'	= 20,000 x ₹ 10.50	₹ 2,10,000
MF 'B'	= 20,000 x ₹ 22.80	₹ 4,56,000
MF 'C'	= 20,000 x ₹ 20.80	₹ 4,16,000
Total		**₹ 10,82,000**

(iii) Yield on each Fund

	Capital Yield	Dividend Yield	Total	Yield (%)
MF 'A'	₹ 2,10,000 - ₹ 2,00,000 = ₹ 10,000	₹ 6,000	₹ 16,000.00	8.00
MF 'B'	₹ 4,56,000 - ₹ 5,00,000 = - ₹ 44,000	₹ 25,000	- ₹ 19,000.00	-3.80
MF 'C'	₹ 4,16,000 - ₹ 4,00,000 = ₹ 16,000	₹ 16,000	₹ 32,000.00	8.00
Total			₹ 29,000.00	

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No. of Days Investment Held

	MF 'A'	MF 'B'	MF 'C'
Period of Holding (Days)	$\frac{8.00}{9.733}\times 365$ = 300 Days	$\frac{-3.80}{-11.185}\times 365$ = 124 Days	$\frac{8.00}{15.00}\times 365$ = 195 Days

(iv) Date of Original Investment 04.06.21 27.11.21 17.09.21

(v) Total Yield $= \frac{₹29,000.00}{₹11,00,000}\times 100 = 2.636\%$

(vi) If past of all three schemes will continue for next one year, the investor should redeem the units of MFs 'A' and 'B' and invest the proceeds in MF 'C'. The expected return next will be 15%.

(vii) If the Mutual funds are charging exit load of 5%, if investment is redeemed within one year, then investor should get redeemed units of MF 'B' now and units of MF 'A' after 65 days.

(b) No. of Shares = $\frac{₹\ 1,900\,\text{crores}}{₹\ 50}$ = 38 crores

$$EPS = \frac{PAT}{No.of\ shares}$$

$$EPS = \frac{₹\ 560\,\text{crores}}{38\,\text{crores}} = ₹\ 14.737$$

Cost of Equity = $R_f + ß\ (R_m - R_f)$

= 9.5 + 0.1 (12.6 – 9.5) = 9.81%

FCFE = Net income – [(1-b) (capex – dep) + (1-b) (ΔWC)]

FCFE = 14.737 – [(1-0.43) (53-45) + (1-0.43) (4.62)]

= 14.737 – [4.56 + 2.6334] = 7.5436

$$P_o = \frac{FCFE(1+g)}{K_e - g} = \frac{7.5436(1.07)}{0.0981-0.07} = \frac{8.0716}{0.0281} = ₹\ 287.25$$

(c) Outcomes of the financial planning are:

(i) **Financial Objectives:** Financial objectives are to be decided at the very outset so that rest of the decisions can be taken accordingly. The objectives need to be consistent with the corporate mission and corporate objectives.

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(ii) Financial Decision Making: Financial decision making helps in analyzing the financial problems that are being faced by the corporate and accordingly deciding the course of action to be taken by it.

(iii) Financial Measures: The financial measures like ratio analysis, analysis of cash flow statement etc. are used to evaluate the performance of the Company. The selection of these measures again depends upon the corporate objective.

Question 3

(a) Skylark Systems Ltd. is interested to expand its operations in US for which it requires funds of $ 20 million, net of issue expenses and floatation costs etc., which amounts to 3% of the issue size. To finance this project it proposes to issue GDR.

Following factors are considered in pricing the issue:

(i) Expected market price of share at the time of issue of GDR is ₹ 300 (FV ₹ 10)

(ii) 3 shares shall underlay each GDR and shall be priced at 10% discount to market price.

(iii) Expected exchange rate is ₹ 75/$

(iv) 20% Dividend is expected to be paid for next year with growth rate of 15%

You are required to compute the number of GDRs to be issued and cost of GDR to Skylark Systems Ltd.

If the company is able to raise the funds in US at the rate of 4% p.a. and the company is able to repay the loan along with interest from revenues generated from the operations of US, what is your advise to the company? **(8 Marks)**

(b) You have been given the following information about Swecha Ltd.

	Swecha Ltd.		Market		
Year	Average Share price	Dividend per share	Average Index	Dividend Yield %	Return on Govt. bond %
2017	460	30	4060	5	5.5
2018	497	33	4320	6.5	5.5
2019	523	38	4592	4.5	5.5
2020	556	43	4780	6	5.5
2021	589	50	4968	5.5	5.5

(i) Compute the Beta value of the company as at the end of year 2021.

(ii) What is your Observation? **(8 Marks)**

(c) What are Foreign Currency Convertible Bonds? What are their advantages? **(4 Marks)**

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Answer

(a) Working Notes:

Net Issue Size = $ 20 million

Gross Issue = $\frac{20.00}{0.97}$ = $ 20.619 million

Issue Price per GDR in ₹ (300 x 3 x 90%)	₹ 810
Issue Price per GDR in $ (₹ 810/ ₹ 75)	$ 10.80
Dividend Per GDR (D_1) = ₹ 2 x 3 =	₹ 6.00
Net Proceeds Per GDR = ₹ 810 x 0.97 =	₹ 785.70

Number of GDR to be issued

$$\frac{\$\ 20.619\ \text{million}}{\$\ 10.80} = 1.9092\ \text{million}$$

Cost of GDR

$$k_e = \frac{6.00}{785.70} + 0.15 = 15.76\%$$

If the company receives an offer from US Bank willing to provide an equivalent amount of loan with interest rate of 4%, it should accept the offer.

(b) (i) Computation of Beta Value

Calculation of Returns

$$\text{Returns} = \frac{D_1 + (P_1 - P_0)}{P_0} \times 100$$

Year	Returns from Swecha Ltd.	Returns from market Index
2018	$\frac{33 + (497 - 460)}{460} \times 100 = 15.22\%$	$\frac{(4320 - 4060)}{4060} \times 100 + 6.50\% = 12.90\%$
2019	$\frac{38 + (523 - 497)}{497} \times 100 = 12.88\%$	$\frac{(4592 - 4320)}{4320} \times 100 + 4.50\% = 10.80\%$
2020	$\frac{43 + (556 - 523)}{523} \times 100 = 14.53\%$	$\frac{(4780 - 4592)}{4592} \times 100 + 6.00\% = 10.09\%$
2021	$\frac{50 + (589 - 556)}{556} \times 100 = 14.93\%$	$\frac{(4968 - 4780)}{4780} \times 100 + 5.50\% = 9.43\%$

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Computation of Beta

Year	Swecha Ltd. (X)	Market Index (Y)	XY	Y^2
2018	15.22%	12.90%	196.34	166.41
2019	12.88%	10.80%	139.10	116.64
2020	14.53%	10.09%	146.61	101.81
2021	14.93%	9.43%	140.79	88.92
Total	57.56%	43.22%	622.84	473.78

Average Return of Krishna Ltd. = $\frac{57.56}{4}$ = 14.39%

Average Market Return = $\frac{43.22}{4}$ = 10.81%

$$\text{Beta } (\beta) = \frac{\sum XY - n\bar{X}\bar{Y}}{\sum Y^2 - n(\bar{Y})^2} = \frac{622.84 - 4\times14.39\times10.81}{473.78 - 4(10.81)^2} = 0.097$$

(ii) Observation

	Expected Return (%)	Actual Return (%)	Action
2017	5.5% + 0.097(12.90% - 5.5%) = 6.22%	15.22%	Buy
2018	5.5% + 0.097(10.80% - 5.5%) = 6.01%	12.88%	Buy
2019	5.5% + 0.097(10.09% - 5.5%) = 5.95%	14.53%	Buy
2020	5.5% + 0.097(9.43% - 5.5%) = 5.88%	14.93%	Buy

(c) A type of convertible bond issued in a currency different than the issuer's domestic currency. In other words, the money being raised by the issuing company is in the form of a foreign currency. A convertible bond is a mix between a debt and equity instrument. It acts like a bond by making regular coupon and principal payments, but these bonds also give the bondholder the option to convert the bond into stock.

Advantages of FCCBs

(i) The convertible bond gives the investor the flexibility to convert the bond into equity at a price or redeem the bond at the end of a specified period, normally three years if the price of the share has not met his expectations.

(ii) Companies prefer bonds as it leads to delayed dilution of equity and allows company to avoid any current dilution in earnings per share that a further issuance of equity would cause.

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(iii) FCCBs are easily marketable as investors enjoys option of conversion into equity if resulting to capital appreciation. Further investor is assured of a minimum fixed interest earnings.

Question 4

(a) Following information is available pertaining to ABC Ltd. which is expected to grow at a higher rate for 3 years after which growth rate will stabilize at a lower level.

Base year information is -

Revenues	EBIT (After Depreciation)	Capital Expenditure	Depreciation
₹ 1,000 Cr.	₹ 150 Cr.	₹ 140 Cr.	₹ 100 Cr.

Information for high growth and stable growth period are as follows:

Stable Growth

Particulars	High Growth	Stable Growth
Growth in Revenue & EBIT	20%	10%
Growth in Capital Expenditure and Depreciation	20%	Capital Expenditure are offset by Depreciation
Risk free rate	10%	9%
Equity Beta	1.15	1.00
Market Risk Premium	6%	5%
PreTax cost of Debt	13%	12.86%
Debt Equity Ratio	1:1	2:3

Working capital is 25% of Revenue for all time.

Corporate Tax Rate is 30%.

You are requested to find out the value of ABC Ltd. ***(8 Marks)***

(b) A mutual fund made an issue of New Fund Offer (NFO) on 01/01/2021 of 10.00 Lakh Units of ₹ 10 each. No entry load was charged. It made the following investments:

Particulars	(₹)
25,000 Equity Shares of XYZ Ltd., ₹ 100 each @ ₹ 320	80,00,000
5% Government Securities	4,00,000
10% NCDs Unlisted	5,00,000
8% Listed Debentures	10,00,000

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During the year, dividends of ₹ 8.00 lakhs were received on equity shares. Interest on all types of debt securities were received. On 31st December 2021 equity shares were appreciated by 15% while listed debentures were quoted at 20% premium.

XYZ Ltd., on 15th December 2021 in its AGM declared the interim dividend of 10% and bonus shares at 1:10 with the record date of 28th December 2021.

(i) Find out the NAV per unit as on 31st December given that the operating expenses paid during the year amounting to ₹ 3,00,000.

(ii) Find out the NAV, if the MF had distributed a dividend of, ₹ 0.50 per unit during the year to the investors.

(iii) If you are the investor, find out what is the annualised return you have got.

(8 Marks)

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

Answer

(a)

	High growth phase:	Stable growth phase:
k_e	0.10 + 1.15 x 0.06 = 0.169 or 16.9%.	0.09 + 1.0 x 0.05 = 0.14 or 14%.
k_d	0.13 x (1 - 0.3) = 0.091 or 9.1%.	0.1286 x (1 - 0.3) = 0.09 or 9%.
Cost of capital	0.5 x 0.169 + 0.5 x 0.091 = 0.13 or 13%.	0.6 x 0.14 + 0.4 x 0.09 = 0.12 or 12%.

Determination of forecasted Free Cash Flow of the Firm (FCFF)

(₹ in crores)

	Yr. 1	Yr. 2	Yr. 3	Terminal Year
Revenue	1200.00	1440.00	1728.00	1900.80
EBIT	180.00	216.00	259.20	285.12
EAT	126.00	151.20	181.44	199.58
Capital Expenditure	48.00	57.60	69.12	-
Less Depreciation				
Δ Working Capital	50.00	60.00	72.00	43.20
Free Cash Flow (FCF)	**28.00**	**33.60**	**40.32**	**156.38**

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Alternatively, it can also be computed as follows:

(₹ in crores)

	Yr. 1	Yr. 2	Yr. 3	Terminal Year
Revenue	1200.00	1440.00	1728.00	1900.80
EBIT	180.00	216.00	259.20	285.12
EAT	126.00	151.20	181.44	199.58
Add: Depreciation	120.00	144.00	172.80	190.08
	246.00	295.20	354.24	389.66
Less: Capital Exp.	168.00	201.60	241.92	190.08
Δ WC	50.00	60.00	72.00	43.20
	28.00	**33.60**	**40.32**	**156.38**

Present Value (PV) of FCFF during the explicit forecast period is:

FCFF (₹ in crores)	PVF @ 13%	PV (₹ in crores)
28.00	0.885	24.78
33.60	0.783	26.31
40.32	0.693	27.94
		₹ 79.03

Terminal Value of Cash Flow = $\frac{156.38}{0.12-0.10}$ = ₹ 7819 Crore

PV of the terminal, value is = ₹ 7819 Crore x $\frac{1}{(1.13)^3}$

= ₹ 7819 Crore x 0.693 = ₹ 5418.57 Crore

The value of the firm is = ₹ 79.03 Crores + ₹ 5418.57 Crores = ₹ 5497.60 Crores

(b) (i) In order to find out the NAV, the cash balance at the end of the year is calculated as follows-

Particulars	₹
Cash balance in the beginning	
(₹ 100 lakhs – ₹ 99 lakhs)	1,00,000
Dividend Received	8,00,000
Interest on 5% Govt. Securities	20,000
Interest on 10% NCDs	50,000

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Interest on 8% Debentures	80,000
Interim Dividend	2,50,000
	13,00,000
(-) Operating expenses	3,00,000
Net cash balance at the end	10,00,000
Calculation of NAV	₹
Cash Balance	10,00,000
5% Govt. Securities (at par)	4,00,000
27,500 equity shares @ ₹ 368 each	1,01,20,000
10% NCDs (Unlisted) at cost	5,00,000
8% Debentures @ 120%	12,00,000
Total Assets	1,32,20,000
No. of Units	10,00,000
NAV per Unit	₹ 13.22

(ii) Calculation of NAV, if dividend of ₹ 0.50 is paid –

Net Assets (₹ 1,32,20,000 – ₹ 5,00,000)	₹ 1,27,20,000
No. of Units	10,00,000
NAV per unit	₹ 12.72

(iii) Annualised Return

$$= \frac{13.22-10.00}{10.00} \times 100 = 32.20\%$$

Or

$$= \frac{[12.72-10.00]+0.50}{10.00} \times 100 = 32.20\%$$

(c) The benefits of securitization can be viewed from the angle of various parties involved as follows:

(A) From the angle of originator

Originator (entity which sells assets collectively to Special Purpose Vehicle) achieves the following benefits from securitization.

(i) **Off – Balance Sheet Financing:** When loan/receivables are securitized it releases a portion of capital tied up in these assets resulting in off Balance Sheet

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financing leading to improved liquidity position which helps in expanding the business of the company.

(ii) **More specialization in main business**: By transferring the assets the entity could concentrate more on core business as servicing of loan is transferred to SPV. Further, in case of non-recourse arrangement even the burden of default is shifted.

(iii) **Helps to improve financial ratios**: Especially in case of Financial Institutions and Banks, it helps to manage Capital –To-Weighted Asset Ratio effectively.

(iv) **Reduced borrowing Cost**: Since securitized papers are rated due to credit enhancement even they can also be issued at reduced rate as of debts and hence the originator earns a spread, resulting in reduced cost of borrowings.

(B) From the angle of investor

Following benefits accrues to the investors of securitized securities.

(i) **Diversification of Risk**: Purchase of securities backed by different types of assets provides the diversification of portfolio resulting in reduction of risk.

(ii) **Regulatory requirement**: Acquisition of asset backed belonging to a particular industry say micro industry helps banks to meet regulatory requirement of investment of fund in industry specific.

(iii) **Protection against default**: In case of recourse arrangement if there is any default by any third party then originator shall make good the least amount. Moreover, there can be insurance arrangement for compensation for any such default.

Question 5

(a) M/s. Vasavi Ltd. is considering the takeover of M/s. SKPD Ltd. by the exchange of five new shares in M/s. Vasavi Ltd. for every eight shares in M/s. SKPD Ltd. The relevant financial details of the two companies prior to merger announcement are as follows:

Particulars	*M/s. Vasavi Ltd.*	*M/s. SKPD Ltd.*
Profit before tax (₹ crore)	*18*	*20.8*
No. of shares (in crore)	*20*	*18*
P/E ratio	*11*	*8*

Corporate tax rate 30%.

You are required to determine:

a. Market value of both the companies

b. Value of original share holders

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c. *Price per share after merger*

d. *Effect on share price of both the companies. If the directors of Vasavi Ltd. expect their own pre-merger P/E ratio to be applied to the combined earnings.* ***(8 Marks)***

(b) *Closing Values of NIFTY Index from 3rd to 12th day of the month of January 2022 were as follows:*

Days	Date	Closing Values of NIFTY Index
1	03/01/2022	17626
2	04/01/2022	17805
3	05/01/2022	17925
4	06/01/2022	17746
5	07/01/2022	17813
6	10/01/2022	18003
7	11/01/2022	18056
8	12/01/2022	18212

The simple moving average of NIFTY Index for the month of December 2021 was 17174.

You are required to calculate

(i) *The value of exponent for 15 days EMA.*

(ii) *The exponential moving average (EMA) of NIFTY during the above period. (Calculations to be done up to 2 decimals only)*

(iii) *Analyse the buy & sell signal on the basis of your calculations* ***(8 Marks)***

(c) *Briefly explain:*

(a) *Compliance risk and*

(b) *Operational risk* ***(4 Marks)***

Answer

(a)

	M/s Vasavi Ltd.	M/s SKPD Ltd.
Profit before Tax (₹ in crore)	18.00	20.80
Tax 30% (₹ in crore)	5.40	6.24
Profit after Tax (₹ in crore)	12.60	14.56
Earnings per Share	$\frac{12.60}{20}$ = ₹ 0.63	$\frac{14.56}{18}$ = ₹ 0.81
Price per Share before Merger (EPS x P/E Ratio)	₹ 0.63 x 11 = ₹ 6.93	₹ 0.81 x 8 = ₹ 6.48

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a. Market Value of company

M/s Vasavi Ltd. = ₹ 6.93 x 20 Crore = ₹ 138.60 crore

M/s SKPD Ltd. = ₹ 6.48 x 18 Crore = ₹ 116.64 crore

b. Value of Original Shareholders

After Merger

	M/s Vasavi Ltd.	M/s SKPD Ltd.
No. of Shares	20 crores	$18 \times \frac{5}{8} = 11.25$ crores
Combined	31.25 crores	
% of Combined Equity Owned	$\frac{20}{31.25} \times 100 = 64.00\%$	$\frac{11.25}{31.25} \times 100 = 36.00\%$
Value of Original Shareholders	₹ 255.24 crore x 64.00% = ₹ 163.35 crores	₹ 255.24 crore x 36% = ₹ 91.89 crores

c. Price per Share after Merger

$EPS = \frac{₹\ 27.16\,crore}{31.25\,crore} =$ ₹ 0.87 per share

P/E Ratio = 11

Market Value Per Share = ₹ 0.87 X 11 = ₹ 9.57

d. Effect on Share Price

M/s Vasavi Ltd.

Gain/loss (-) per share = ₹ 9.57 – ₹ 6.93 = ₹ 2.64

i.e. $\frac{9.57 - 6.93}{6.93} \times 100 = 0.381$ or 38.10%

∴ Share price would increase by 38.10%

M/s SKPD Ltd.

$9.57 \times \frac{5}{8} =$ ₹ 5.98

Gain/loss (-) per share = ₹ 5.97 – ₹ 6.48 = (₹ 0.51)

i.e. $\frac{5.97 - 6.48}{6.48} \times 100 = (0.0787)$ or (-7.87%)

∴ Share Price would decrease by 7.87%.

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(b) (i) Value of Exponent for 15 days EMA

$$= \frac{2}{n+1} = 0.125$$

(ii) $EMA_t = a \times P_t + (1 - a)(EMA_{(t-1)})$ Where, a = exponent, P_t = Price of today

Date	1 NIFTY	2 EMA for Previous day ($EMA_{(t-1)}$)	3 1-2	4 3 × 0.125	5 EMA 2 + 4
03/01/2022	17626	17174	452	56.50	17230.50
04/01/2022	17805	17230.50	574.50	71.81	17302.31
05/01/2022	17925	17302.31	622.69	77.84	17380.15
06/01/2022	17746	17380.15	365.85	45.73	17425.88
07/01/2022	17813	17425.88	387.12	48.39	17474.27
10/01/2022	18003	17474.27	528.73	66.09	17540.36
11/01/2022	18056	17540.36	515.64	64.45	17604.82
12/01/2022	18212	17604.82	607.18	75.90	17680.71

(iii) A buy (bullish) signal is generated when actual price line (NIFTY in the give case) rises through the moving average, while a sell a (bearish) signal is generated when actual NIFTY level declines through the moving averages. In the case under consideration the price line of NIFTY never breaches the 15-day EMA line. In-fact it is hovering around the 15-day EMA line only.

(c) (a) Compliance Risk: Every business needs to comply with rules and regulations. For example, with the advent of Companies Act, 2013, and continuous updating of SEBI guidelines, each business organization has to comply with plethora of rules, regulations and guidelines. Noncompliance leads to penalties in the form of fine and imprisonment.

However, when a company ventures into a new business line or a new geographical area, the real problem then occurs. For example, a company pursuing cement business likely to venture into sugar business in a different state but laws applicable to the sugar mills in that state are different. So, that poses a compliance risk. If the company fails to comply with laws related to a new area or industry or sector, it will pose a serious threat to its survival.

(b) Operational Risk: This type of risk relates to internal risk. It also relates to failure on the part of the company to cope with day-to-day operational problems. Operational risk relates to 'people' as well as 'process'. We will take an example to illustrate this.

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For example, an employee paying out ₹ 1,00,000 from the account of the company instead of ₹ 10,000.

This is a people as well as a process risk. An organization can employ another person to check the work of that person who has mistakenly paid ₹ 1,00,000 or it can install an electronic system that can flag off an unusual amount.

Question 6

(a) Calculate the Covariance & Correlation Coefficient of the two securities, from the historical rates of return over the past 10 years.

Years	***1***	***2***	***3***	***4***	***5***	***6***	***7***	***8***	***9***	***10***
Security 1 (Return %)	*15*	*10*	*12*	*8*	*18*	*16*	*20*	*24*	*16*	*14*
Security 2 (Return %)	*24*	*20*	*18*	*14*	*22*	*26*	*12*	*28*	*16*	*15*

(8 Marks)

(b) MPD Ltd. issues a ₹ 50 Million Floating Rate Loan on July 1, 2018 with resetting of coupon rate every 6 Months equal to LIBOR + 50 bps.

MPD is interested in an Interest rate Collar Strategy of selling a Floor and buying a cap.

MPD buys the 3 years cap and sell 3 years Floor as per the following details on July 1, 2018:

Principal Amount	*₹ 50 Million*
Strike Rate	*5% for Floor & 8% for Cap*
Reference Rate	*6 months LIBOR*
Premium	*NIL, since premium paid for cap = premium received for Floor*

The Reset dates & Interest rates p.a., on that dates are:

Reset Date	***31/12/2018***	***30/06/2019***	***31/12/2019***	***30/06/2020***	***31/12/2020***	***30/06/2021***
LIBOR (%)	*7.00*	*8.00*	*6.00*	*4.75*	*4.25*	*5.25*

Using the above data, you are required to determine:

(i) Effective Interest paid out at each six reset dates, (Round off to the nearest rupee)

(ii) Average overall effective rate of interest p.a. (round off to 2 decimals) ***(8 Marks)***

(c) Define Angle Investors, are these only individuals? If not, list the entities.

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OR

Enlist the criteria for an entity to be classified as a Startup entity under the Startup India Scheme initiated by the Government of India. ***(4 Marks)***

Answer

(a) Calculation of Covariance

Year	R_1	*Deviation* $(R_1 - \overline{R_1})$	*Deviation* $(R_1 - \overline{R_1})^2$	R_2	*Deviation* $(R_2 - \overline{R_2})$	*Deviation* $(R_2 - \overline{R_2})^2$	*Product of deviations*
1	15	-0.3	0.09	24	4.5	20.25	-1.35
2	10	-5.3	28.09	20	0.5	0.25	-2.65
3	12	-3.3	10.89	18	-1.5	2.25	4.95
4	8	-7.3	53.29	14	-5.5	30.25	40.15
5	18	2.7	7.29	22	2.5	6.25	6.75
6	16	0.7	0.49	26	6.5	42.25	4.55
7	20	4.7	22.09	12	-7.5	56.25	-35.25
8	24	8.7	75.69	28	8.5	72.25	73.95
9	16	0.7	0.49	16	-3.5	12.25	-2.45
10	14	-1.3	1.69	15	-4.5	20.25	5.85
	153		Σ= 200.10	195		Σ=262.50	94.50

$\overline{R_1} = \frac{153}{10} = 15.30$

$\overline{R_2} = \frac{195}{10} = 19.50$

$$\text{Covariance} = \frac{\sum_{i=1}^{N} [R_1 - \overline{R_1}][R_2 - \overline{R_2}]}{N} = 94.50/10 = 9.45$$

Standard Deviation of Security 1

$$\sigma_1 = \sqrt{\frac{(R_1 - \overline{R_1})^2}{N}}$$

$$\sigma_1 = \sqrt{\frac{200.10}{10}} = \sqrt{20.01}$$

$\sigma_1 = 4.47$

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Standard Deviation of Security 2

$$\sigma_2 = \sqrt{\frac{(R_2 - \overline{R_2})^2}{N}}$$

$$\sigma_2 = \sqrt{\frac{262.50}{10}} = \sqrt{26.25}$$

$\sigma_2 = 5.12$

Alternatively, Standard Deviation of securities can also be calculated as follows:

Year	R_1	R_1^2	R_2	R_2^2
1	15	225	24	576
2	10	100	20	400
3	12	144	18	324
4	8	64	14	196
5	18	324	22	484
6	16	256	26	676
7	20	400	12	144
8	24	576	28	784
9	16	256	16	256
10	14	196	15	225
	153	2541	195.00	4065

Standard deviation of security 1:

$$\sigma_1 = \sqrt{\frac{N\sum R_1^2 - (\sum R_1)^2}{N^2}}$$

$$\sigma_1 = \sqrt{\frac{10\times 2541 - (153)^2}{10^2}} = \sqrt{\frac{25410 - 23409}{100}}$$

$$\sigma_1 = \sqrt{\frac{2001}{100}} = \sqrt{20.01}$$

$\sigma_1 = 4.47$

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Standard deviation of security 2:

$$\sigma_2 = \sqrt{\frac{N\sum R_2^2 - (\sum R_2)^2}{N^2}}$$

$$\sigma_2 = \sqrt{\frac{10 \times 4065 - (195)^2}{10^2}} = \sqrt{\frac{40650 - 38025}{100}}$$

$$\sigma_2 = \sqrt{\frac{2625}{100}} = \sqrt{26.25}$$

$\sigma_2 = 5.12$

Correlation Coefficient

$$r_{12} = \frac{Cov}{\sigma_1 \sigma_2} = \frac{9.45}{4.47 \times 5.12} = 0.413$$

(b) (i) The pay-off of each leg shall be computed as follows:

Cap Receipt

Max {0, [Notional principal x (LIBOR on Reset date – Cap Strike Rate) x (No. of days in settlement period/ 365)}

Floor Pay-off

Max {0, [Notional principal x (Floor Strike Rate – LIBOR on Reset date) x (No. of days in settlement period/ 365)}

Statement showing effective interest on each payment date

Reset Date	LIBOR (%)	Date of Payment	Days	Interest Payment (₹) LIBOR+0.50%	Cap Receipts (₹)	Floor Pay-off (₹)	Effective Interest
31-12-2018	7.00	30-06-2019	181	18,59,589	0	0	18,59,589
30-06-2019	8.00	31-12-2019	184	21,42,466	0	0	21,42,466
31-12-2019	6.00	30-06-2020	182	16,16,120	0	0	16,16,120
30-06-2020	4.75	31-12-2020	184	13,19,672	0	62,842	13,82,514
31-12-2020	4.25	30-06-2021	181	11,77,740	0	1,85,959	13,63,699
30-06-2021	5.25	31-12-2021	184	14,49,315	0	0	14,49,315
Total			1096				98,13,703

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(ii) Average Annual Effective Interest Rate shall be computed as follows:

$$\frac{98,13,703}{5,00,00,000} \times \frac{365}{1096} \times 100 = 6.54\%$$

(c) Despite being a country of many cultures and communities traditionally inclined to business and entrepreneurship, India still ranks low on comparative ratings across entrepreneurship, innovation and ease of doing business. The reasons are obvious. These include our old and outdated draconian rules and regulations which provides a hindrance to our business environment for a long time. Other reasons are red-tapism, our time-consuming procedures, and lack of general support for entrepreneurship. Off course, things are changing in recent times.

Angle Investors invest in small startups or entrepreneurs. Often angle investors are among the entrepreneur's family and friends.

Though angel investors usually represent individuals, the entity that actually provides the fund may be a limited liability company, a business, a trust or an investment fund, among many other kinds of vehicles.

OR

As per Government Notification, an entity shall be considered as a Startup:

i. Upto a period of ten years from the date of incorporation/ registration, if it is incorporated as a private limited company (as defined in the Companies Act, 2013) or registered as a partnership firm (registered under section 59 of the Partnership Act, 1932) or a limited liability partnership (under the Limited Liability Partnership Act, 2008) in India.

ii. Turnover of the entity for any of the financial years since incorporation/ registration has not exceeded one hundred crore rupees.

iii. Entity is working towards innovation, development or improvement of products or processes or services, or if it is a scalable business model with a high potential of employment generation or wealth creation.

Provided that an entity formed by splitting up or reconstruction of an existing business shall not be considered a 'Startup'.

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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) *PQR & Associates, Chartered Accountants, is a partnership firm having 3 partners CA P, CA Q and CA R. PQR & Associates are appointed as Statutory Auditors of ABC Limited, a listed entity for the financial year 2021-22 and CA P is appointed as Engagement Partner for the audit of ABC Limited. Before issuing the Audit Report of ABC Limited, CA P asked CA R to perform Engagement Quality Control Review and is of the view that his responsibility will be reduced after review by CA R. Whether the contention of CA P is correct? What are the aspects that need to be considered by CA R while performing Engagement Quality Control Review for audit of financial statements of ABC Limited?*

(5 Marks)

(b) *JKL Limited is engaged in the business of Construction and real estate having various projects across states. M/s YT & Co, Chartered Accountants have been appointed as Statutory Auditors. Audit Team from M/s YT & Co for audit of JKL Limited comprises of CA Z-Engagement Partner, CA Q, a paid assistant and 3 Articled Assistants. During preliminary verification, CA Z observed that huge amount of sub-contract payments were made to M/s JB Associates, a partnership firm in which Director of JKL Limited is a managing partner. The engagement team discussed that SA 315 and SA 240 shall include specific consideration of the susceptibility of the financial statements to material misstatement due to fraud or error that could result from the JKL Limited's related party relationships and transaction. Highlight the matters that are to be addressed in the discussion by CA Z with engagement team members with reference to the relevant Standard on Auditing.* ***(5 Marks)***

(c) *Beta Hotel operates in an automated environment and uses application softwares for front desk, Guest reservations, Restaurant and kitchen orders and billing for which CA Anil has been appointed as an auditor. Guide CA Anil the various key aspects that needs to be considered by him while understanding of the automated environment of the Company in accordance with SA 315. Is he required to document the same? If yes, illustrate by giving one example.* ***(4 Marks)***

Answer

(a) **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 review does not reduce the responsibilities of the engagement partner. Hence, contention of CA. P that after engagement quality control review by CA. R, his responsibility will be reduced, is not correct.

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However, CA. R needs to consider the following aspect while performing Engagement Quality Control Review for audit of financial statements of a listed entity ABC Ltd.:

1. The engagement team's evaluation of the firm's independence in relation to the specific engagement.
2. Significant risks identified during the engagement and the responses to those risks.
3. Judgments made, particularly with respect to materiality and significant risks.
4. Whether appropriate consultation has taken place on matters involving differences of opinion or other difficult or contentious matters, and the conclusions arising from those consultations.
5. The significance and disposition of corrected and uncorrected misstatements identified during the engagement.
6. The matters to be communicated to management and those charged with governance and, where applicable, other parties such as regulatory bodies.
7. Whether working papers selected for review reflect the work performed in relation to the significant judgments and support the conclusions reached.
8. The appropriateness of the report to be issued.

Engagement quality control reviews for engagements other than audits of financial statements of listed entities may, depending on the circumstances, include some or all of these considerations.

(b) **As per SA 550 "Related Parties",** the engagement team discussion that SA 315 and SA 240 require shall include specific consideration of the susceptibility of the financial statements to material misstatement due to fraud or error that could result from the entity's related party relationships and transactions.

Accordingly matters that are to be addressed in the discussion by CA Z among the engagement team include:

1. The nature and extent of the entity's relationships and transactions with related parties (using, for example, the auditor's record of identified related parties updated after each audit).
2. An emphasis on the importance of maintaining professional skepticism throughout the audit regarding the potential for material misstatement associated with related party relationships and transactions.
3. The circumstances or conditions of the entity that may indicate the existence of related party relationships or transactions that management has not identified or disclosed to the auditor (e.g., a complex organisational structure, use of special-purpose entities for off-balance sheet transactions, or an inadequate information system).

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4. The records or documents that may indicate the existence of related party relationships or transactions.

5. The importance that management and those charged with governance attach to the identification, appropriate accounting for, and disclosure of related party relationships and transactions (if the applicable financial reporting framework establishes related party requirements), and the related risk of management override of relevant controls.

6. In addition, the discussion in the context of fraud may include specific consideration of how related parties may be involved in fraud. For example:

   (a) how special-purpose entities controlled by management might be used to facilitate earnings management.

   (b) how transactions between the entity and a known business partner of a key member of management could be arranged to facilitate misappropriation of the entity's assets.

(c) Understanding and Documenting Automated Environment: Understanding of the automated environment of a company is required as per SA 315. The auditor's understanding of the automated environment should include the following:

1. The applications that are being used by the company;

2. Details of the IT infrastructure components for each of the application;

3. The organisation structure and governance;

4. The policies, procedures and processes followed;

5. IT risks and controls.

The auditor is required to document the understanding of a company's automated environment as per SA 230. The illustration below is an example of how an auditor can document details of an automated environment:

Application	Used for	Database	Operating System	Network	Server and Storage
SAP ECC/ HANA	Integrated application software	Oracle 19c	HP-UX	LAN, WAN	HP Server and NAS
REVS	Front Desk, Guest Reservations	MS-SQL Server 2018	Windows 2016 Server	In-house developed	HP Server Internal HDD
KOTS	Restaurant and Kitchen Orders	MS-SQL Server 2018	Windows 2016 Server	In-house developed	HP Server Internal HDD

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BILLSYS	Billing	Oracle 12c	Windows 2016 Server	Packaged Software	HP Server Internal HDD

Question 2

(a) *Mr. K has been appointed as statutory auditor of SK Limited for issuing an audit opinion on financial statements and internal controls over financial reporting (ICFR) for the year ended March 31, 2022 under the Companies Act, 2013. Guide Mr. K to prepare a checklist in the form of questions for testing internal control over cash and bank balances. When forming an opinion on ICFR is it necessary for Mr. K to test the transactions only at the balance sheet date?* ***(5 Marks)***

(b) *Jam Private Limited was engaged in business of manufacture of Cycles. CA Roy was appointed as a Statutory Auditor of the Company for the financial year 2021-22. During the year under audit, Jam Private Limited obtained working capital facilities from ABC Bank Limited for ₹10 crore hypothecating the Stock of goods as primary security. On inquiry CA Roy was informed by management that stock statements are furnished periodically to ABC Bank Limited and the details of submission of quarterly stock statement are as follows:*

Period of Quarter	*Stock Value as per Books of Account as at the end of the quarter (₹ in crores)*	*Stock Value as per quarterly statement submitted to ABC Bank Limited as at the end of quarter (₹ in crore)*
Q1-2021-22	*11.50*	*14.00*
Q2-2021-22	*14.75*	*17.00*
Q3-2021-22	*11.50*	*14.00*
Q4-2021-22	*15.25*	*15.25*

The management of Jam Private Limited did not disclose the above variations in notes to accounts forming part financial Statements of the Company for the year 2021-22. The management replied that there are no variations as on the Balance sheet date and further they are of the view that stock statement furnished to bank is only a formality and computed arbitrarily only for the purpose of securing higher drawing power and hence statutory auditors need not be bothered.

Is the contention of the management valid? As a Statutory Auditor how CA Roy should deal and discuss the disclosure/reporting requirements if any, as per the Companies Act, 2013 and CARO, 2020. ***(5 Marks)***

(c) *CA Ravi, a practising Chartered Accountant, was proprietor of M/s Ravi & Associates. CA Ravi died on 15th September, 2020 due to cardiac arrest. Only family member left behind CA Ravi was his wife, Roohi. On 30th September, 2021, Roohi sold the practice of her husband to CA Balwan for ₹ 25 Lacs along with right to use the firm name i.e.,*

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M/s. Ravi & Associates and requested the Institute to consider the effect of such sale. Give your comments on the following issues with reference to the Chartered Accountants Act, 1949 and Schedules thereto:

(i) Whether Roohi can sell the practice to CA Balwan?

(ii) Can CA Balwan continue to practice as proprietor in name of M/s Ravi & Associates?

(4 Marks)

Answer

(a) In the given case of SK Limited, the appointed auditor Mr. K would prepare checklist for testing internal control over cash and bank balances. An illustrative set of questions to be answered by the audit staff is as follows:

Have you checked that the cashier -

(i) is not responsible for opening the incoming mails;

(ii) does not authorise any of the ledgers;

(iii) does not authorise any expenditure or receipt;

(iv) does not sign cheques;

(v) takes his annual leave regularly;

(vi) inks and balances the cash book every day;

(vii) verifies physical cash balance with the book figure daily at the end of the day;

(viii) prepares monthly bank reconciliation statement;

(ix) holds no other funds or investment;

(x) holds no unnecessary balance in hand;

(xi) does not pay money without looking into compliance with proper procedure and due authorisation; and

(xii) has tendered proper security or has executed a fidelity bond?

In the given situation, Mr. K is Statutory Auditor of SK Limited for issuing opinion on financial statements and internal control over financial reporting. He should surely test transactions during the financial year and not just as at the balance sheet date, though the extent of testing at or near the balance sheet date may be higher. From the discussion given above, it can be concluded that it would not be necessary for Mr. K to test the transactions only at the balance sheet date.

(b) As per clause (vii) of point Y of Schedule III to the Companies Act, 2013 - Division I - Financial Statements for a company whose financial statements are required to comply with the Companies (Accounting Standard) Rules, 2006, "where the company has borrowings from banks or financial institutions on the basis of security of current assets, it

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shall disclose the following :

(a) whether quarterly returns or statements of current assets filed by the company with banks or financial institutions are in agreement with the books of accounts.

(b) if not, summary of reconciliation and reasons of material discrepancies, if any to be adequately disclosed.

Further, as per para 3(ii) (b) of CARO 2020, the auditor is required to report whether during any point of time of the year, the company has been sanctioned working capital limits in excess of five crore rupees, in aggregate, from banks or financial institutions on the basis of security of current assets; whether the quarterly returns or statements filed by the company with such banks or financial institutions are in agreement with the books of account of the Company, if not, give details.

The above clause requires CA Roy to comment on whether during any point of time of the year, the company has been sanctioned working capital limits in excess of ₹ 5 crores in aggregate. Jam (P) Ltd. has been sanctioned working capital facilities/limit of ₹ 10 crores which is apparently in excess of ₹ 5 crores.

Secondly, whether the quarterly returns filed by the Jam (P) Ltd. company with ABC Bank Ltd. are in agreement with the book of accounts of the company.

According to the data given in the instant situation, it is clear that there are variations in Quarter 1, Quarter 2 & Quarter 3 requiring reporting under this clause because of difference in stock value as per Book of Accounts & Stock Value as per Quarterly returns submitted to ABC Bank Ltd.

Therefore, Contention of the management is not valid.

CA. Roy should report the differences as per the Companies Act, 2013 and CARO 2020 as follows:

	Stock value as per Book Accounts (₹ in Crore)	Stock value as per quarterly statement Submitted to ABC Bank Ltd. (₹ in Crore)	Variation
Q - 1	11.50	14.00	Excess reporting of stock to Bank by 2.50 crore
Q - 2	14.75	17.00	Excess reporting of stock to Bank by 2.25 Crore
Q - 3	11.50	14.00	Excess reporting of stock to bank by 2.50 crore

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(c) Sale of Goodwill: With reference to Clause (2) of Part I to the First Schedule to Chartered Accountants' Act, 1949, the Council of the Institute of Chartered Accountants of India considered whether the goodwill of a proprietary concern of chartered accountant can be sold to another member who is otherwise eligible, after the death of the proprietor.

It is being resolved that the legal heir of the deceased member has to obtain the permission of the Council within a year of the death of the proprietor concerned.

It further lays down that the sale is permitted subject to certain conditions like such a sale is completed/effected in all respects and the Institute's permission to practice in deceased's proprietary firm name is sought within a year of the death of such proprietor concerned. In respect of these cases, the name of the proprietary firm concerned would be kept in abeyance (i.e. not removed on receipt of information about the death of the proprietor as is being done at present) only upto a period of one year from the death of proprietor concerned as aforesaid.

In the given case, Mrs. Roohi, widow of Mr. Ravi, proprietor of M/s. Ravi & Associates, has sold the practice along with right to use the firm name after one year of his death for ₹ 25 lakhs. This sale is in effect the sale of goodwill.

From the discussion given above it can be concluded that:

(i) Mrs. Roohi cannot sell the practice of CA. Balwan with right to use the firm name.

(ii) CA Balwan cannot continue to practice in the name of the firm M/s. Ravi & Associates as a proprietor because the name of the firm M/s. Ravi & Associates would be kept in abeyance only up to a period of one year from the death of the proprietor.

Question 3

(a) M/s PQR Auto, a partnership firm, is engaged in manufacture of automobile spare parts having factory at Surat. CA S was appointed as the Tax Auditor of M/s PQR Auto for the Assessment Year 2022-2023. While carrying out the Tax Audit under section 44AB of the Income-tax Act, 1961. CA S observed following:

(i) Interest of ₹ 50,000 paid to Vendor X who was registered under MSME Act, 2006.

(ii) Interest payment ₹ 10,000 was incurred in relation to earning exempt interest income from Tax Relief bonds.

(iii) Sum of ₹ 1,00,000 was received from Mr. X, for sale of one plant and machinery. But due to non-compliance of one of the conditions as specified in the contract with Mr. X, M/s. PQR Auto forfeited ₹ 1,00,000 during AY 2022-23 as per forfeiture clause mentioned in the contract.

Guide CA S in reporting the above transactions under the relevant clauses in Form No. 3CD. ***(5 Marks)***

(b) TQR Limited is engaged in the business of garment manufacturing having registered office at Mumbai and branches across India. Mr. Shyam, one of the senior Managers was

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involved in creating false documents and legitimate documents were altered to support fictitious transactions. Consequently, the management appointed you to get forensic audit done based on the digital foot-print of transactions handled by Mr. Shyam. The use of sound techniques will enable to discover the defalcations on a timely basis. As a forensic auditor how will you deal and suggest Technology based/Digital forensic techniques.

(5 Marks)

(c) CA K qualified as Chartered Accountant and started practice as proprietor in the name of M/s K & Associates in the year 2015-16. LST Limited, a listed entity, appointed M/s K & Associates as Statutory Auditor for the year ended 31st March, 2022. CA K signed the balance sheet of LST Limited for the year ended 31st March, 2022 on 14th May, 2022. M/s K & Associates never subjected themselves to the Peer Review process of the Institute since its inception of practice. Comment with reference to the Chartered Accountants Act, 1949 and Schedules thereto. ***(4 Marks)***

Answer

(a) (i) As per Clause 22 of Form 3CD of the Income-tax Act, 1961, the tax auditor is required to state the amount of interest inadmissible under section 23 of the Micro, Small and Medium Enterprises Development Act, 2006. Section 23 of the MSME Act lays down that an interest payable or paid by the buyer, in accordance with the provisions of this Act, shall not be allowed as a deduction for the purposes of the computation of income under the Income-tax Act,1961.

Accordingly, the CA. S is required to report the payment of interest of ₹ 50,000 to Vendor X who was registered under MSME Act, 2006 under clause 22 of Form 3CD of the Income-tax Act, 1961.

(ii) As per Clause 21(h) of Form 3CD of the Income-tax Act, 1961, the tax auditor is required to report about the amount of deduction inadmissible in terms of section 14A Income-tax Act, 1961, in respect of the expenditure incurred in relation to income which does not form part of the total income.

Therefore, CA. S, the auditor is required to scrutinize expense accounts particularly interest account to check whether there is included any expense which is relatable to exempt income. He is also required to note down the amount and mention against the clause.

Thus, in the given situation, CA. S is required to report the same as per clause 21 (h) of Form 3CD of the Income-tax Act, 1961.

(iii) As per Clause 29(A) of Form 3CD of the Income-tax Act, 1961 of the Income-tax Act, 1961, the auditor is required to report,

(a) whether any amount is to be included as income chargeable under the head 'income from other sources' as referred to in clause (ix) of sub section (2) of section 56 the Income-tax Act, 1961.

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(b) If yes, to provide the nature of income and amount thereof.

The auditor is also required to obtain a certificate from the assessee regarding all such advances received towards transfer of capital assets which have forfeited during the year and examine whether any amount of such advances has been written back during the year and examine the basis of such write back to determine whether such write back was on account of an act of forfeiture. Further, the auditor is also required to verify the terms of contract to check the conditions to forfeit of such advance and such conditions have occurred, then should verify whether the amount has been actually forfeited.

Thus, same is required to be reported under clause 29(A) of Form 3CD of the Income-tax Act, 1961.

(b) Technology based /Digital Forensics Techniques: Every transaction leaves a digital footprint in today's computer-driven society. Close scrutiny of relevant emails, accounting records, phone logs and target company hard drives is a requisite facet of any modern forensic audit.

Before taking steps such as obtaining data from email etc. the forensic auditor should take appropriate legal advice so that it doesn't amount to invasion of privacy.

Digital investigations can become quite complex and require support from trained digital investigators.

Many open-source digital forensics tools are now available to assist you in this phase of the investigation.

(i)	Cross Drive Analysis	(ii)	Live Analysis	(iii)	Deleted Files
(iv)	Stochastic Forensics	(v)	Steganography	(vi)	EnCase
(vii)	MD5	(viii)	Tracking Log Files	(ix)	PC System Log
(x)	Free Log Tools				

(c) Clause (9) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 states that a Chartered Accountant in practice shall be deemed to be guilty of misconduct if he fails to invite attention to any material departure from the generally accepted procedure of audit applicable to the circumstances.

This clause implies that the audit should be performed in accordance with "generally accepted procedure of audit applicable to the circumstances" and if for any reason the auditor has not been able to perform the audit in accordance with such procedure, his report should draw attention to the material departures from such procedures. What constitutes "generally accepted audit procedure" would depend upon the facts and circumstances of each case, but guidance is available in general terms from the various pronouncements of the Institute is issued by way of Engagement and Quality Control Standards, Statements, General Clarifications, Guidance Notes Technical Guides, Practice Manuals, Studies and Other Papers.

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Audit of Listed Companies: Pursuant to SEBI Notification, statutory audit of listed companies under the Companies Act, 2013 shall be done by only those auditors who have subjected themselves to the Peer Review process of the Institute, and hold a valid certificate issued by the Peer Review Board of the ICAI.

In the given case of M/s. K & Associates, who is appointed auditor of a listed entity LST Limited for the year ended 31.03.2022, CA K, the proprietor signed the balance sheet on 14.05.2022 but never subjected the firm to the Peer Review process of the Institute. CA K would be held guilty of professional misconduct under clause (9) of Part I of Second Schedule of the Chartered Accountants Act, 1949. Also, CA K did not comply with the SEBI Notification which was required to be complied with.

Alternative Solution

Clause (1) of Part II of the Second Schedule to the Chartered Accountants Act, 1949 states that a chartered accountant in practice shall be deemed to be guilty of misconduct if he contravenes any of the provisions of this Act or the regulations made thereunder or any guidelines issued by the Council. It requires every member of the institute to act within the framework of the Chartered Accountants Act, 1949 and the regulations and guidelines made by Council thereunder.

The Statement on Peer Review shall be deemed to be a guideline of the Council under Clause (1) of Part II of Second Schedule to the Act and it is obligatory for the Practice Unit to comply with the provisions contained in this Statement.

As per the Statement every Practice Unit including its branches who has conducted Statutory Audit of Enterprises whose equity or debt securities are listed in India or abroad as defined under SEBI(LODR) regulations, 2015, will be subject to Peer Review in accordance with this statement.

Audit of Listed Companies: Pursuant to SEBI Notification, Statutory Audit of Listed Companies under the Companies Act, 2013 shall be done by only those auditors who have subjected themselves to the Peer Review process of the Institute, and hold a valid certificate issued by the Peer Review Board of the ICAI.

In the given case of M/s K & Associates, who is appointed auditor of a listed entity LST Limited for the year ended 31.03.2022, Mr K, the proprietor signed the Balance sheet on 14.05.2022 but never subjected the firm to the Peer Review process of the Institute. Hence, CA K would be held guilty of professional misconduct under clause (1) of Part II of Second Schedule of the Chartered Accountants Act, 1949.

Question 4

(a) *Comment on the following in the light of certificate of compliance of conditions of Corporate Governance to be issued under SEBI (LODR) Regulations 2015, for a Listed Company (one among the top 1000 listed companies) where the Board consists of 20 directors with a Non-executive director as its Chairman and further-*

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(i) One Non-executive Director has attained the age of 70 years;

(ii) One of the Directors is a Director in eight other listed entities;

(iii) The Managing Director is serving as Independent Director in four listed entities of which one entity's equity shares are not listed on a Stock exchange;

(iv) The Non-executive Chairman is the promoter of the Listed Entity which has nine Independent Directors;

(v) One Independent Director has been serving as Independent Director in eight listed entities of which equity shares are listed on a Stock Exchange. ***(5 Marks)***

(b) Your firm has been appointed as Central Statutory Auditors of a Nationalised Bank for the financial year 2021-22. During the course of audit your audit team observed that a lump sum amount has been disclosed as Contingent Liability collectively though the components are correctly identified. In respect of contingent liabilities, the auditor is primarily, concerned with seeking reasonable assurance that all the contingent liabilities are identified and properly valued and the audit firm intends to obtain a representation from the 'management. Highlight the points/checklists that are to be covered in the management representation. ***(5 Marks)***

(c) XYZ Limited is manufacturer of soaps and cosmetics having business operations in Delhi. XYZ Limited is planning to expand its operations across India. Before expansion, the top management of XYZ Limited is willing to· appoint CA T for conducting Management Audit of XYZ Limited. However, the top management of XYZ Limited is afraid that Management Audit may lead to the breeding of antagonism on the part of the Company. The top management of XYZ Limited approached CA T and requested to explain them the causes of antagonism. Help CA T. ***(4 Marks)***

Answer

(a) (i) One non-executive director has attained the age of 70 years: The auditor should ensure that no listed entity shall appoint a person or continue the directorship of any person as a non-executive director who has attained the age of seventy-five years. In the given situation, there is **no violation** of LODR 2015 for Non-executive director who has attained the age of 70 years.

(ii) One of the Directors is a Director in eight other Listed Entities: As per LODR 2015, a person shall not be a director in more than seven listed entities. In the given situation, there is **non-compliance** as one of the Directors is a Director in eight other listed entities which is exceeding the prescribed limit of seven entities.

(iii) The Managing Director is serving as Independent Director in Four listed entities of which one entity's equity shares are not listed on a Stock Exchange: Any person who is serving as a whole-time director / managing director in any listed entity shall serve as an independent director in not more than three listed entities. For the purpose of above mentioned provision, the count for the number of listed entities on

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which a person is a director / independent director shall be only those whose equity shares are listed on a stock exchange. In the given situation, Managing Director has been serving as Independent Director in four listed entities of which one entity's equity shares are not listed on a stock exchange. So it is not exceeding the prescribed limit of three entities, hence there is no violation of LODR 2015.

(iv) The Non-executive Chairman is the Promoter of the Listed Entity which has nine Independent Directors: The auditor should also verify that if the regular non-executive Chairperson is a promoter of the listed entity or is related to any promoter or person occupying management positions at the Board level or at one level below the Board, at least one-half of the Board of the listed entity shall consist of independent directors. In the given situation, Board consist of 20 directors with a Non-executive Director as its Chairman has 9 independent directors i.e., less than half of Board **is not in compliance with** the requirement of LODR, 2015.

(v) One Independent Director has been serving as Independent Director in Eight Listed Entities of which Equity Shares are listed on a Stock Exchange: A person shall not serve as an independent director in more than seven listed entities in case its equity shares are listed on a Stock Exchange. It may be noted that the count for the number of listed entities on which a person is a director / independent director shall be only those whose equity shares are listed on a stock exchange.

In the given situation, there is **non-compliance** as one of the Independent Director has been serving as Independent Director in eight listed entities which is exceeding the prescribed limit of seven entities.

(b) Contingent Liabilities: In respect of contingent liabilities, the auditor is primarily concerned with seeking reasonable assurance that all contingent liabilities are identified and properly valued. The auditor should obtain representation from management that:-

(i) all off-balance sheet transactions have been accounted in the books of accounts as and when such transaction has taken place;

(ii) all off balance sheet transactions have been entered into after following due procedure laid down;

(iii) all off balance sheet transactions are supported by the underlying documents;

(iv) all year end contingent liabilities have been disclosed;

(v) the disclosed contingent liabilities do not include any crystallised liabilities which are of the nature of loss/ expense and which, therefore, require creation of a provision/adjustment in the financial statements;

(vi) the estimated amounts of financial effect of the contingent liabilities are based on the best estimates in terms of Accounting Standard 29, including consideration of the possibility of any reimbursement;

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(vii) in case of guarantees issued on behalf of the bank's directors, the bank has taken appropriate steps to ensure that adequate and effective arrangements have been made so that the commitments would be met out of the party's own resources and that the bank will not be called upon to grant any loan or advances to meet the liability consequent upon the invocation of the said guarantee(s) and that no violation of section 20 of the Banking Regulation Act, 1949 has arisen on account of such guarantee; and

(viii) such contingent liabilities which have not been disclosed on account of the fact that the possibility of their outcome is remote include the management's justification for reaching such a decision in respect of those contingent liabilities.

Note: Students may be given due credit for any other relevant point quoted.

(c) CA. T as the management auditor, is expected to evaluate the effectiveness of controls, the auditees might fear that the management audit report may create their incompetent impression on the top management of XYZ Limited. Therefore, the management audit may lead to the breeding of antagonism on the part of the auditees. Causes of antagonism are as under:

i. Fear of criticism stemming from adverse audit findings.

ii. Fear of changes in day-today working habits because of changes resulting from audit recommendations.

iii. Punitive action by superiors prompted by reported deficiencies.

iv. Insensitive audit practices - reports which are overly critical, reports which focus on deficiencies only, the air of mystery cloaking some audits, and the perception that auditors gain personally from reporting deficiencies.

v. Hostile audit style - a cold and distant aspect is a lack of understanding of the auditee's problems, an absence of empathy, an air of smugness or superiority, an excessive concentration on insignificant errors, a prosecutional tone when asking questions, and a greater concern with parading defects than helping constructively to improve conditions.

Question 5

(a) You have been appointed as an auditor of Safe Life Insurance Company Limited. During the course of audit you come across several cases of lapsed policies. Management is flooded with complaints from Agents and Life Assured regarding Policy lapses and Revival. The policy lapsation is tracked over the PMS software. You are requested by the Management to explain in clear terms about Policy lapses and Revival. Also state your role as an auditor in verifying the same. ***(5 Marks)***

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(b) *In exercise of the powers conferred by clauses (f) and (g) of Sub-section (2) of Section 29A read with Section 28C and Sub-section (1) of Section 28D of the Chartered Accountants Act, 1949 (38 of 1949), the Central Government has made 'Chartered Accountants (Procedures of Meetings of Quality Review Board, and Terms and Conditions of Service and Allowances of the Chairperson and Members of the Board) Rules, 2006'. Elucidate the powers of Quality Review Board in discharging its functions. How the Quality Review Board would proceed in case it does not receive the information called for by it from any Company?* ***(5 Marks)***

(c) *CA Harry is appointed as a Statutory Auditor of Delist Limited for the financial year 2021-22. M/s Delist Limited is a listed entity at National Stock Exchange and the financial statements are to be drawn up in compliance with Ind AS. M/s Delist Limited made certain fair value accounting estimates on complex financial instruments which are not traded in an active and open market. CA Harry is concerned with identification and assessment of the risks of material misstatement for accounting estimates. Guide him with regard to the estimation making process adopted by management with reference to the relevant Standard on Auditing.* ***(4 Marks)***

Answer

(a) Policy Lapse and Revival: "Lapse" is the discontinuance of the policy owing to non-payment of premium dues. In order to keep a life insurance policy "in force" the policy holder is required to pay premiums when due (either monthly/ quarterly/annual/bi-annual). If payment is missed, the insurer allows a period of 15/30 days from the premium due date for making the payment. This period is termed as "grace period". If the policy holder does not make the payment within the grace period, the policy gets "lapsed". Thus, a payment within the grace period is deemed to be a payment on the due date.

The terms and conditions of the policy stipulate that where the premium is not paid within the grace period, the policy lapses but may be revived during the lifetime of the life assured. Some insurers do not allow revival, if the policy has remained in lapsed condition for more than five years. This is because of the possibility that the arrears of premiums on such a policy would be too heavy and that it would be better to take out a fresh policy.

The insurer should have taken persistent measures for monitoring receipt of renewal premium within the due dates. In case of most of insurers, policy lapsation is tracked over the PMS, wherein premium due dates are monitored by the system once initial data of the policy is entered in the system.

Role of Auditor: The primary objective of the audit is to check and confirm that due dates are recorded and monitored properly and polices are marked as "lapsed" on non-receipt of renewal premium within due dates/grace period. In case of revival request, whether adequate checks are in place for receipt of outstanding amounts and adequate documents are obtained before reviving the policy.

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(b) **Powers of Quality Review Board** : The Government of India has, in exercise of the powers conferred by clauses (f) and (g) of Sub-section (2) of Section 29A read with Section 28C and Sub-section (1) of Section 28D of the Chartered Accountants Act, 1949 (38 of 1949), the Central Government has made 'Chartered Accountants (Procedures of Meetings of Quality Review Board, and Terms and Conditions of Service and Allowances of the Chairperson and Members of the Board) Rules, 2006'. To facilitate the discharge of its functions, Rule 6 of aforesaid rules provides:

i. on its own or through any specialized arrangement set up under the Institute, evaluate and review the quality of work and services provided by the members of the Institute in such manner as it may decide;

ii. lay down the procedure of evaluation criteria to evaluate various services being provided by the members of the Institute and to select, in such manner and form as it may decide, the individuals and firms rendering such services for review;

iii. call for information from the Institute, the Council or its Committees, Members, Clients of members or other persons or organizations, in such form and manner as it may decide, and may also give a hearing to them;

iv. invite experts to provide expert/technical advice or opinion or analysis on any matter or issue which the Board may feel relevant for the purpose of assessing the quality of work and services offered by the members of the Institute;

v. make recommendations to the Council to guide the members of the Institute to improve their professional competence and qualifications, quality of work and services offered and adherence to various statutory and other regulatory requirements and other matters related thereto.

In case, the Board does not receive the information called for by it from any company registered under the Companies Act, 2013, the Board may request the Central Government in the Ministry of Corporate Affairs for assistance in obtaining the information.

(c) As per SA 540 "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures", CA. Harry shall obtain an understanding of the following in order to provide a basis for the identification and assessment of the risks of material misstatements for accounting estimates:

The estimation making process adopted by the management including-

(1) The method, including where applicable the model, used in making the accounting estimates.

(2) Relevant controls.

(3) Whether management has used an expert?

(4) The assumption underlying the accounting estimates.

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(5) Whether there has been or ought to have been a change from the prior period in the methods for making the accounting estimates, and if so, why; and

(6) Whether and, if so, how the management has assessed the effect of estimation uncertainty.

Question 6

(a) *CA H was appointed as a Statutory Auditor of MNL Limited, a listed company, which has three subsidiaries namely M Ltd., N Ltd., L Ltd. and also 15 branches across India. Auditors are duly appointed for the subsidiaries and branches as well. With regard to the determination of materiality during the audit of consolidated financial statements, what should be the considerations of CA H? How he should deal in his report if there are observations (for instance modification and/or emphasis of matter in accordance with SA 705/706) made by component auditors?* ***(5 Marks)***

(b) *You are the team leader of 10 members for an audit of a Multinational Company. All the team members are concerned about audit documentation in order to provide evidence that the audit complies with SAs. Hence, the team members wish to document every matter concerned. In your opinion it is neither necessary nor practicable for the auditor to document every matter considered or professional judgement made in an audit. Further you feel that it is unnecessary for the auditor to document separately compliance with matters for which compliance is demonstrated by documents included within the audit file. Illustrate by giving examples with reference to relevant Standard on Auditing.* ***(5 Marks)***

(c) *Mr. Sirish, a Chartered Accountant in practice, delivered a speech in the national conference organized by the Ministry of Information Technology. While delivering the speech, he told the audience that he is a Cybersecurity Expert and his firm provides services of cloud accounting, IT governance, risk compliance and information security at reasonable rates. He also requested the audience to approach his firm of chartered accountants for these services and at the request of the audience he also distributed his business cards and telephone number of his firm to those in the audience.*

Comment in the light of professional Code of Ethics. ***(4 Marks)***

OR

CA K, a Practising Chartered Accountant, was appointed as Authorized Representative by GKR Limited to appear before National e-assessment centre in the matter of its Faceless Income-tax proceedings for the Assessment year 2020-21. While preparing a reply in response to the notice for the Scrutiny Assessment, CA K observed that there were certain trade payables and loan creditors which were not in existence but was fabricated by the management of GKR Limited. Though CA K knew these accounts were fabricated, he still submitted those false accounts to the National faceless e-assessment centre. What are the liabilities of CA K under the Income-tax Act, 1961?

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Answer

(a) CA. H should consider the requirement of SA 600, "Using the Work of Another Auditor", if he decides to use the work of another auditor in relation to the audit of consolidated financial statements and he should comply with the requirements of SA 600.

In carrying out the audit of the standalone financial statements, the computation of materiality for the purpose of issuing an opinion on the standalone financial statements of each component would be done component-wise on a standalone basis.

However, with regard to determination of materiality during the audit of consolidated financial statements (CFS), the auditor should consider the following:

(i) The auditor is required to compute the materiality for the group as a whole. This materiality should be used to assess the appropriateness of the consolidation adjustments (i.e. permanent consolidation adjustments and current period consolidation adjustments) that are made by the management in the preparation of CFS.

(ii) The parent auditor can also use the materiality computed on the group level to determine whether the component's financial statements are material to the group to determine whether they should scope in additional components, and consider using the work of other auditors as applicable.

(iii) The principal auditor also computes materiality for each component and communicates to the component auditor, if he believes is required for true and fair view on CFS.

However, while considering the observations (for instance modification and /or emphasis of matter in accordance with SA 705/706) of the component auditor in his report on the standalone financial statements, the principles of SA 600 needs to be considered i.e. the parent auditor should comply with the requirements of SA 600, "Using the Work of Another Auditor".

(b) SA 230, "Audit Documentation", provides evidence that the audit complies with SAs. However, it is neither necessary nor practicable for the auditor to document every matter considered, or professional judgment made, in an audit.

For example,

(i) the existence of an adequately documented audit plan demonstrates that the auditor has planned the audit.

(ii) the existence of a signed engagement letter in the audit file demonstrates that the auditor has agreed the terms of the audit engagement with management, or where appropriate, those charged with governance.

(iii) An auditor's report containing an appropriately qualified opinion demonstrates that the auditor has complied with the requirement to express a qualified opinion under the circumstances specified in the SAs.

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(iv) In relation to requirements that apply generally throughout the audit, there may be a number of ways in which compliance with them may be demonstrated within the audit file:

- For example, there may be no single way in which the auditor's professional skepticism is documented. But the audit documentation may nevertheless provide evidence of the auditor's exercise of professional skepticism in accordance with SAs. Such evidence may include specific procedures performed to corroborate management's responses to the auditor's inquiries.
- Similarly, that the engagement partner has taken responsibility for the direction, supervision and performance of the audit in compliance with the SAs may be evidenced in a number of ways within the audit documentation. This may include documentation of the engagement partner's timely involvement in aspects of the audit, such as participation in the team discussion required by SA 315, "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment".

(c) Using Designation Other Than a CA and Providing Details of Services Offered: Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949 states that a Chartered Accountant in practice shall be deemed to be guilty of misconduct if he solicits clients or professional work either directly or indirectly by a circular, advertisement, personal communication or interview or by any other means. Such a restraint has been put so that the members maintain their independence of judgment and may be able to command respect from their prospective clients.

Section 7 of the Chartered Accountants Act, 1949 read with Clause (7) of Part I of the First Schedule to the said Act prohibits advertising of professional attainments or services of a member. It also restrains a member from using any designation or expression other than that of a chartered accountant in documents through which the professional attainments of the member would come to the notice of the public. Under the clause, use of any designation or expression other than chartered accountant for a chartered accountant in practice, on professional documents, visiting cards, etc. amounts to a misconduct unless it be a degree of a university or a title indicating membership of any other professional body recognised by the Central Government or the Council.

In view of above, it is improper to use designation "Cybersecurity Expert" since neither it is a degree of a University established by law in India or recognised by the Central Government nor it is a recognised professional membership by the Central Government or the Council. Therefore, he is deemed to be guilty of professional misconduct under both Clause (6) and Clause (7) as he has used the designation "Cybersecurity Expert" in his speech and also he has made reference to the services provided by his firm of Chartered Accountants at reasonable rates. Distribution of cards to audience is also misconduct in terms of Clause (6).

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OR

(c) False Declaration as Authorized Representative: In connection with proceedings under the Income-tax Act 1961, a Chartered Accountant often acts as the authorized representative of his clients and attends before an Income-tax Authority or the appellate tribunal.

Any person who acts or induces, in any manner another person to make and deliver to the Income-tax Authorities a false account, statement, or declaration, relating to any income chargeable to tax which he knows to be false or does not believe to be true will be liable under section 278 of the Income-tax Act 1961.

Further, in case of submission of any information which is false and which the Chartered Accountant either knows or believes to be false or untrue, he would be liable to rigorous imprisonment which may extend to seven years (in other cases two years) and/or to a fine.

In the instant case, Mr. K, a chartered accountant was appointed as authorize representative by GKR Limited to appear before National E-Assessment Centre in the matter of its faceless Income-tax proceeding. While preparing a reply in response to the notice for the scrutiny assessment, CA. K, submitted false accounts to the National Faceless E-Assessment Centre, knowingly that certain trade payables and loan creditors accounts were not in existence and were fabricated by Management.

In view of above, CA. K would be liable under section 278 of the Income-tax Act, 1961.

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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) *Pharma Limited is a company listed with Bombay Stock Exchange. The company is having 500 small shareholders. 50 shareholders have proposed to appoint Amar as a Director as their representative on the Board of Directors of the company. Amar is holding 1000 equity shares of ₹ 10 each in the said company. State, in the light of the provisions of the Companies Act, 2013, whether the proposal to appoint Amar as a Small Shareholders' Director can be adopted by the company. Also state, can the company appoint Small Shareholders' Director, if there is no such proposal moved by the small shareholders.*

(4 Marks)

(b) *PCR Limited has appointed Mr. Vivek, a person resident in India, as a Managing Director who has taken a charge of the post on 1st June, 2021. The remuneration package sanctioned to him is as below:*

Sr. No.	*Particulars*	*₹*
1	*Salary*	*60,00,000*
2	*Rent free accommodation*	*6,00,000*
3	*Children education allowance*	*3,00,000*
4	*Leave Travel Concession Package*	*3,00,000*
5	*Premium in respect of insurance taken for indemnification*	*5,00,000*

It has, further, been informed that-

(a) *Mr. Vivek has availed the Leave Travel Concession Package which will not be pro-rated for 2021-22.*

(b) *Mr. Vivek is not proved guilty during the financial year 2021-22 with respect to the above insurance policy.*

(c) *The company has not passed a special resolution for payment of remuneration in excess of the limit prescribed by schedule V to the Companies Act, 2013.*

(d) *The company has incurred losses during the financial year 2020-21 and 2021-22.*

(e) *The effective capital of the company as at 31st March, 2021 is in negative.*

Based on the above details and referring to the provisions of the Companies Act, 2013, you are requested to analysis and answer the following:

(i) *Compute the amount that would constitute the yearly remuneration for Mr. Vivek.*

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(ii) Compute the excess remuneration paid to Mr. Vivek, if any, and discuss the prospects of recovery thereof. ***(6 Marks)***

(c) Green Developers Limited proposes to acquire a land owned by its Director, Mr. Manoj at a fair market value of ₹10.00 Crores to execute a project of developing a commercial and residential complex on that land. In consideration, the company will allot certain flats of equivalent value to Mr. Manoj on completion of the project. Referring to the provisions of the Companies Act, 2013, advise the Board of Directors of the company whether Green Developers Limited can enter into the proposed arrangement and what will happen, if compliance requirement is contravened? ***(4 Marks)***

Answer

(a) Appointment of Small Shareholders' Director:

According to Section 151 of the Companies Act, 2013 read with Rule 7 of the Companies (Appointment and Qualification of Directors) Rules, 2014,

A listed company may, upon notice of not less than:

(a) one thousand small shareholders; or

(b) 1/10th of the total number of such shareholders,

whichever is lower, have a small shareholders' director elected by the small shareholders.

However, a listed Company may opt to have a director on suo moto representing small shareholders.

The term "small shareholders" means a shareholder holding shares of nominal value of not more than ₹ 20,000 or such other sum as may be prescribed.

(i) Proposal to appoint Mr. Amar as a Small Shareholders' Director:

In the instant case, since 50 small shareholders' have proposed to appoint Amar as their representative, the said proposal is valid and can be adopted as 1/10th of 500 small shareholders' comes to 50. Also, the nominal value of shares held by Amar is ₹ 10,000 (i.e.1000 equity shares of ₹10/- each) which is below the maximum limit of ₹ 20,000.

(ii) If there is no such proposal moved by the small shareholders:

For the second part of the question, yes, the Company can suo moto appoint small Shareholders' director, even if there is no such proposal moved by the small shareholders.

(b) (i) Computation of the amount that would constitute the yearly remuneration for Mr. Vivek

As per **Section 2(78)** of the Companies Act, 2013, (the Act) the term **"Remuneration** "means any money or its equivalent given or passed to any person for services rendered by him and includes perquisites as defined under the Income Tax Act, 1961.

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Further, as per **Section 197(13)** of the Act, where any indemnification insurance is taken by a Company on behalf of Managing Director or other managerial personnel, the premium therefor paid by the Company shall not form part of the remuneration payable to any such personnel, if that person is proved not to be guilty during the year of insurance coverage.

In the light of the provided information in the problem and as per Section 197 read with Schedule V to the Companies Act, 2013, the computation of the amount that would constitute the yearly remuneration of Mr. Vivek in PCR Limited for the FY 2021-2022 will be as under:

Sl. No.	Particulars	In ₹ (proportionate to 10 months as the MD has taken charge of the post w.e.f. 01.06.2021)
1.	Salary	50,00,000
2.	Rent Free Accommodation	5,00,000
3.	Children Education Allowance	2,50,000
4	Leave Travel Concession Package (not pro-rated for 2021-22 as per the question)	3,00,000
	Total yearly remuneration of Mr. Vivek	**60,50,000**

NOTE:

Premium in respect of insurance taken for indemnification is not considered, as Mr. Vivek is not proved guilty during FY 2021-2022.

(ii) Computation of excess Remuneration paid to Mr. Vivek

It is provided that the Company has suffered losses during the FY 2020-2021 and 2021-2022 and the effective capital of the Company as at 31st March, 2021 is in negative. So, as per the Act read with Schedule V, the maximum yearly managerial remuneration payable to Mr. Vivek shall be ₹ 60 Lakhs including perquisites.

From the above table of computation, the total yearly remuneration of Mr. Vivek is arrived ₹ 60,50,000 (pro-rated) and whereas, for the year 2021-2022, Mr. Vivek will be entitled for maximum remuneration payable not exceeding ₹ 50 lakhs per annum (pro-rated for 10 months).

Thus the excess remuneration paid to Mr. Vivek is ₹10,50,000/- [i.e.₹60,50,000 (-) ₹ 50,00,000].

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Prospects of Recovery thereof:

As per Sections 197(9) and 197(10) of the Companies Act, 2013, where the remuneration received by any director is in excess of the limit it shall be refunded to the Company by such director and till that time he holds it in trust for the Company.

The Company shall not waive the recovery of any sum which is refundable to it unless the waiver is approved by a Special Resolution passed by the Company within two years from the date the sum becomes refundable.

In the given case, as the remuneration package sanctioned to him of ₹ 10,50,000/- is in excess of the prescribed limit and as provided in the question, that no special resolution is passed for payment of remuneration in excess of the limit prescribed by Schedule V to the Act.

Therefore, the Company can recover the excess amount.

(c) Restriction on acquiring assets for consideration other than cash:

According to **Section 192 (1)** of the Companies Act, 2013, no company shall enter into an arrangement by which-

(a) a director of the Company or its holding, subsidiary or associate company or a person connected with him acquires or is to acquire assets for consideration other than cash, from the Company; or

(b) the Company acquires or is to acquire assets for consideration other than cash, from such director or person so connected.

Relaxation of Restriction:

The above restriction shall be relaxed *i.e.* the company may enter into an arrangement involving non- cash transactions as stated above, if prior approval for such arrangement is accorded by a resolution of the Company in general meeting.

Advise to the Board:

Hence, in view of the above provisions of law, the Board of Directors of Green Developers Limited shall be advised that the proposed arrangement cannot be entered into by the Company. However, the proposed arrangement may be executed, if prior approval of the Company by way of an ordinary resolution is accorded thereto failing which the contract shall be voidable at the option of the Company.

Further, where the director or the connected person is a director of its holding company, approval shall also be required to be obtained by passing a resolution in general meeting of the holding company.

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What happens if Section 192 is contravened?

Any arrangement entered into by a Company or its holding company in contravention of the provisions of Section 192 shall be voidable at the instance of the Company.

The arrangement shall not be voidable;

(a) if the restitution of any money or other consideration which is the subject-matter of the arrangement is no longer possible and the Company has been indemnified by any other person for any loss or damage caused to it; or

(b) if any rights are acquired *bona fide* for value and without notice of the contravention of the provisions of this section *(i.e.* Section 192) by any other person.

Hence, the Board of Directors of Green Developers Limited can enter into the proposed arrangement by taking into account the above provisions.

Question 2

(a) STC Limited is a wholly owned subsidiary of HTC Limited. The 100% equity shares, fully paid-up, of STC Limited is held by HTC Limited including the shares held by 6 nominees of HTC Limited. In order to effectively utilise the resources, a proposal is under discussion in the board meeting of HTC Limited for merger of both the companies. The majority of the directors of HTC Limited opined in the board meeting that the merger has to be done through fast track mode as per the provisions of Section 233 of the Companies Act, 2013. However, the Company Secretary was of the view that the merger of both the companies cannot be done through fast track mode as they are public companies. Referring to the provisions of the Companies Act, 2013-

(i) Analyze the validity of merger of HTC Limited and STC Limited through fast track mode.

(ii) Examine, whether STC Limited can be merged with HTC Limited, if HTC Limited is a foreign company. ***(4 Marks)***

(b) SOPS Limited is in the field of manufacturing of toys. The company has Authorised Share Capital of ₹ 50 Lakhs consisting of 40,000 equity shares of ₹ 100 each and 10,000 preference shares of ₹100 each. The company has issued 32,000 equity shares and 8,000 preference shares of which 24,000 equity shares and 6,000 preference shares are subscribed and fully paid-up. The company has 650 members holding equity shares and 200 members holding preference shares. A petition was submitted before the Tribunal signed by 90 members holding 3,100 equity shares of the company alleging various acts of oppression and mismanagement on the part of the company. During pendency of the petition, 10 petitioner-members holding 1,000 equity shares disassociated from the petition. Referring to the provisions of the Companies Act, 2013, answer the following:

(i) Whether the petition will be admitted?

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(ii) Whether the petition will be maintainable after disassociation of the stated members?

(4 Marks)

(c) On 1st day of April, 2020, Alm Food Processors Limited, a company engaged in food processor manufacturing unit, entered into a joint venture agreement with Ron and Col Limited, the largest manufacturer of Food processors. Both the companies are registered under the Companies Act, 2013. The joint venture agreement does not contain the term for referring the dispute relating to the quality of the goods supplied to the arbitration. In light of the Arbitration and Conciliation Act, 1996, examine, what will happen, if the parties later on agreed to refer the dispute to the arbitration concerning quality of goods supplied in 2021? ***(3 Marks)***

(d) LMR Limited, a banking company has a "Record Preservation Policy" which inter alia states to maintain the documents evidencing identity of its clients and beneficial owners for a period of 5 years after the account has been closed. Evaluate, whether the "Record Preservation Policy" of the Company has fulfilled its obligation under the provisions of the Prevention of Money Laundering Act, 2002? ***(3 Marks)***

Answer

(a) (i) Companies who may enter into scheme of Merger or Amalgamation [Section 233 (1)]:

A scheme of merger or amalgamation may be entered into between two or more small companies or between a holding company and its wholly-owned subsidiary company or class or classes of companies as may be prescribed (i.e. between two or more start-up companies or one or more start- up company with one or more small company) if 100% of its share capital is held by the holding company, except the shares held by the nominee or nominees to ensure that the number of members of subsidiary company is not reduced below the statutory limit as provided in section 187 of the Companies Act, 2013.

Validity of Merger of HTC Limited and STC Limited through Fast Track Mode.

In the instant case, the 100% equity shares of STC Limited is held by HTC Limited including the shares held by 6 nominees of HTC Limited.

Yes, proposal for the merger of HTC Limited and STC Limited opined by the Board of Directors through fast track mode will be valid subject to the following:-

(a) A notice of the proposed scheme inviting objections or suggestions, if any, from the Registrar and Official Liquidators where registered office of the respective companies are situated or persons affected by the scheme within thirty days is issued by the transferor company or companies and the transferee company

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(b) The objections and suggestions received are to be considered by the companies in their respective general meetings and the scheme is approved by the respective members or class of members at a general meeting holding at least ninety per cent of the total number of shares;

(c) Each of the companies involved in the merger files a declaration of solvency, in the prescribed form, with the Registrar of the place where the registered office of the company is situated; and

(d) The scheme is approved by majority representing nine-tenths in value of the creditors or class of creditors of respective companies indicated in a meeting convened by the company by giving a notice of twenty-one days along with the scheme to its creditors for the purpose or otherwise approved in writing.

Contention of Company Secretary that the merger of both the companies cannot be done through fast track mode as they are public companies, is incorrect.

(ii) Merger of STC Limited with HTC Limited, a Foreign Company:

Section 234 of the Companies Act, 2013 makes provisions in respect of cross border mergers and amalgamations i.e. between Indian Company and a foreign body corporate. Procedure has been prescribed in Rule 25A of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016. According to this Section, STC Ltd. can be merged with HTC Ltd. (if it's a foreign company) with RBI approval and after complying with provisions of Sections 230 to 232 of the Act and relevant Rules.

(b) Right to apply for Oppression and Mis-management:

As per the provisions of Section 244 of the Companies Act, 2013, in the case of a company having share capital, members eligible to apply for oppression and mismanagement shall be lowest of the following:

- 100 members; or
- 1/10th of the total number of members; or
- Members holding not less than 1/10th of the issued share capital of the company.

Provided that the applicant or applicants has or have paid all calls and other sums due on his or their shares.

The share holding pattern of SOPS Limited is given as follows:

₹ 40,00,000 issued share capital (equity and preference) held by 850 members

The petition alleging oppression and mismanagement has been made by some members as follows:

(i) No. of members making the petition - 90 members holding 3100 equity shares of ₹100/- each.

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(ii) Amount of share capital held by members making the petition - ₹ 3,10,000

The petition shall be valid if it has been made by the lowest of the following:

- 100 members; or
- 85 members (being 1/10th of 850); or
- Members holding ₹ 4,00,000 share capital (being 1/10th of ₹40,00,000)

(i) Whether the Petition is maintainable?

As it is evident, the petition made by 90 members meets the eligibility criteria specified under Section 244 of the Companies Act, 2013 as it exceeds the minimum requirement of 85 members in this case. Therefore, the petition is maintainable.

(ii) Whether the petition is maintainable even after disassociation of the stated members? The consent to be given by a shareholder is reckoned at the beginning of the proceedings. The withdrawal of consent by any shareholder during the course of proceedings shall not affect the maintainability of the petition ***[Rajamundhry Electric Corporation Vs. V. Nageswar Rao*** **A.I.R.].**

Hence, the petition will be maintainable even after disassociation of the stated members i.e. by 10 petitioner members holding 1,000 equity shares.

(c) In the given question, the Joint Venture Agreement (JVA) between Alm Food Processors Limited and Ron and Col Limited, does not contain the term for referring the dispute relating to the quality of the goods supplied to the arbitration. To resolve this dispute, the parties later entered into an agreement to refer the dispute to the arbitration concerning quality of goods supplied in 2021.As per the Arbitration and Conciliation Act, 1996, the purpose of an arbitration agreement is to submit disputes to arbitration on the basis of whether existing or future disputes would be submitted to arbitration. Where an agreement is entered into after the disputes have arisen, then, it would be called as a 'submission agreement".

Conclusion: Thus, a submission agreement may be entered by the parties that shall be submitted arbitration, whereby they agree to abide by the decision of the arbitrator.

(d) Section 12 of the Prevention of Money Laundering Act, 2002 provides for the obligation of Banking Companies, Financial Institutions and Intermediaries i.e. the reporting entity to maintain records of all transactions.

According to sub-section (1)(e), every reporting entity shall maintain record of documents evidencing identity of its clients and beneficial owners as well as account files and business correspondence relating to its clients.

Maintenance of Records: The records referred to in clause (e) of sub-section (1) of documents evidencing identity of its clients and beneficial owners as well as account files and business correspondence relating to its clients shall be maintained for a period of five years after the business relationship between a client and the reporting entity has ended or the account has been closed, whichever is later.

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The records shall contain information about nature of transaction, amount of transaction, currency, date of transaction and parties to transaction as per the respective Rules of the Prevention of Money- laundering (Maintenance of Records) Rules, 2005.

Conclusion

In view of the above, LMR Limited has not fulfilled its obligation to maintain the above stated documents for a period of 5 years after the business relationship between a client and the Company has ended or the account has been closed, whichever is later. The Preservation Policy of the Company does not provide such conditions stated above.

Question 3

(a) Green Rose Limited is regularly filing its annual financial statements with the Registrar of Companies (RoC). The Company is suffering losses continuously for the past 5 years. The annual financial statements disclosed that the liabilities are ten times of its assets as per the latest audited financial statements. Based on the financial position revealed by the financial statements filed with his office, the RoC came to the conclusion that the Company should be wound up in the public interest being unable to pay its debts. The RoC filed a petition before the Tribunal [NCLT] under Section 272 of the Companies Act, 2013 for winding up of the Company without obtaining previous approval therefor. Referring to the provisions of the Companies Act, 2013.

(i) Enumerate the circumstances in which a company may be wound up by the Tribunal.

(ii) Examine the validity of the petition filed by the RoC. ***(4 Marks)***

(b) RFC Limited has been incorporated in Singapore and has a business place in Mumbai. The company has issued 5,00,000 shares of USD 100 each, consisting of 4,00,000 equity shares and 1,00,000 preference shares. The issued share capital is fully paid up except 5,000 preference shares where USD 50 per share is unpaid.

RJW, an Indian citizen is holding 26,000 preference shares which include 1100 partly paid-up shares and Ronte Limited incorporated in New-Delhi (India) is holding 2,23,500 equity shares in RFC Limited.

The Registrar of Companies issued notice under Section 379 of the Companies Act, 2013 addressed to the person whose name and address has been delivered to the Registrar by RFC Limited for compliance under the Companies Act, 2013 for foreign companies.

The above notice was Delivered at the address which was given by RFC Limited to the Registrar of Companies.

Answer the following, referring to the provisions of the Companies Act, 2013:

(i) Whether RFC Limited is a foreign company?

(ii) Whether service of notice by the Registrar of companies is valid? ***(4 Marks)***

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(c) TZ is a promoter director of Ind Exports Limited engaged in the export of software products to various countries in the world. ZZ, a customer in U.S. to whom the company exported certain products, failed to pay the amount due for these exports. Later, the company settled the amount for 50% with ZZ and the amount was transferred through hawala to India. The money so received was partly used by the company to part finance its office building in Mumbai and the balance of the money to part finance the residential flat in Delhi purchased by TC, a son of TZ. During the search in the premises of hawala businessman, some documentary evidences were captured by the search officer and based on which, the Adjudicating Authority appointed under the Prevention of Money Laundering Act, 2002 issued an order attaching the office of Ind Exports Limited and the flat of TC alleged to be involved in scheduled offence of money laundering.

Based on the above scenario, answer the following as per the provisions of the Prevention of Money Laundering Act, 2002 (the Act):

(i) What is the scheduled offence?

(ii) Where an order for confiscation has been made, all the rights and title in such property shall vest in President of India. Examine the statement.

(iii) Advise Ind Export Limited about the remedy available under the Act. ***(6 Marks)***

Answer

(a) (i) Circumstances in which company may be wound up by Tribunal:

According to Section 271 of the Companies Act, 2013, a company may be wound up by the Tribunal in the following circumstances, where-

(a) the company has, by special resolution, resolved that the company be wound up by the Tribunal;

(b) the company has acted against the interests of the sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality;

(c) on an application made by the Registrar or any other person authorised by the Central Government. The Tribunal is of the opinion that the affairs of the company have been conducted in a fraudulent manner/ formed for fraudulent and unlawful purpose / the persons concerned in the formation or management of its affairs have been guilty of fraud, misfeasance or misconduct in connection therewith and that it is proper that the company be wound up;

(d) the company has made a default in filing with the Registrar its financial statements or annual returns for immediately preceding five consecutive financial years; or

(e) the Tribunal is of the opinion that it is just and equitable that the company should be wound up.

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(ii) Validity of the petition filed by the RoC

According to Section 272 of the Companies Act, 2013, the Registrar of Company is entitled to present a petition for winding up under section 271 except on the grounds specified in clause (a) of that Section.

Provided that the Registrar shall obtain the previous sanction of the Central Government to the presentation of a petition. The Central Government shall not accord its sanction unless the company has been given a reasonable opportunity of making representations.

Here in the given instance, RoC filed a petition before the Tribunal for winding up without obtaining previous approval of the Central Government.

Therefore, the petition filed by the RoC is invalid.

(b) (i) Whether RFC Limited is a Foreign Company ?

Definition of a Foreign Company

As per **Section 2(42)** of the Companies Act, 2013, "Foreign Company" means any company or body corporate incorporated outside India which has a place of business in India whether by itself or through an agent, physically or through electronic mode; and conducts any business activity in India.

Provision of Section 379(2): Requirement of holding of paid up share capital of Foreign Company:

Further, in the light of the inputs given in the problem, where not less than 50% of the paid-up share capital, whether equity or preference or partly equity and partly preference, of a foreign company incorporated outside India is held by one or more citizens of India and one or more companies or bodies corporate incorporated in India, whether singly or in the aggregate, such foreign company shall also comply with the provisions of Chapter XXII and such other provisions of this Act as may be prescribed with regard to the business carried on by it in India as if it were a company incorporated in India. [Section 379(2)]

In the given case, RFC Limited, incorporated in Singapore has a business place in Mumbai. The Company has issued 5,00,000 shares of USD 100 each i.e. of USD 5,00,00,000 comprising of USD 4,00,00,000 equity share capital (i.e. 4 lac* USD 100) and USD 1,00,00,000 preference share capital (i.e,1 lac * USD 100).

As the issued capital was fully paid up except 5,000 preferences shares (i..e, 5000* 50= USD 2,50,000), so, total paid up share capital of the RFC limited is:

Equity Share Capital	USD 4,00,00,000
Preference Share Capital (Full Paid)	USD 95,00,000
Preference Share Capital (Partly Paid)	USD 2,50,000
Total Paid up Share Capital	USD 4,97,50,000

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As per facts, shareholding by RJW, an Indian citizen is USD 25,45,000 preference share capital (i.e. 26,000 shares *USD 100- 1100 shares * USD 50) and Ronte Limited incorporated in New-Delhi (India) is holding USD 2,23,50,000 equity share capital (i.e., 2,23,500 *USD 100) in RFC Limited. Aggregate shareholding is USD 2,48,95,000.

As per requirement of Section 379(2), RJW, an Indian citizen and Ronte Limited incorporated (an Indian Company) were holding more than 50% of the shareholding (i.e. 50%* USD 4,97,50,000 = 2,48,75,000) in RFC Limited.

Therefore, RFC Ltd. is not only a foreign company as per Section 2(42) but shall also be complying with the provisions of Chapter XXII and other provisions of this Act with regard to the business carried on by it in India, as if it were a company incorporated in India as per Section 397(2) .

(ii) Whether service of notice by the RoC is valid?

Yes, the service of notice by the Registrar of Companies is valid in the light of Section 383 of the Companies Act, 2013. According to the provision any process, notice, or other document required to be served on a foreign company, shall be deemed to be sufficiently served, if addressed to any person whose name and address have been delivered to the Registrar and left at, or sent by post to, the address which has been so delivered to the Registrar or by electronic mode.

(c) (i) Scheduled Offence

The term "Scheduled Offence" has been defined in clause (y) of sub-section (1) of Section 2 of the Prevention of Money Laundering Act, 2002. It means -

(a) the offences specified under Part A of the Schedule; or

(b) the offences specified under Part B of the Schedule if the total value involved in such offences is one crore rupees or more; or

(c) The offences specified under Part C of the Schedule.

(ii) Whether all the rights and title in property vest in President of India

According to Section 9 of the Prevention of Money Laundering Act, 2002, where an order of confiscation has been passed in respect of any property of a person, all the rights and title in such property shall vest absolutely in the Central Government free from all encumbrances. Therefore, the statement that right and title in property shall vest in President of India on the passing of an order of confiscation, is incorrect.

(iii) Remedies Available

According to Section 5 of the Prevention of Money Laundering Act, 2002, Ind Exports Limited shall have right to enjoy or use its Office. The flat purchased by TC, son of TZ can enjoy the rights during the period of provisional attachment being an interested person here.

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Also, under Section 26 and 42 of the Act, Ind Exports Limited, if being aggrieved by an order made by the Adjudicating Authority on the attachment order, may prefer an appeal to the Appellate Tribunal. The appeal shall be filed within 45 days from the date on which a copy of the order made by the Adjudicating Authority is received and appeal further in the High Court against any decision or order of the Appellate Tribunal.

Question 4

(a) ABC Limited mobilized the funds from the public towards development of plots under "Cash-down Payment Scheme". The said scheme, inter alia, stipulates the following terms & conditions.

(i) The plot will be allotted to the customer after completion of 9 months from the date of agreement.

(ii) No specific plot is mentioned at the time of entering into the agreement.

(iii) The company has authority for developing and maintaining the plots.

(iv) The amount mobilized under the scheme will be utilized for the purpose of the scheme.

(v) The customers do not have day-to-day control over the development of plots.

Other information:

(i) The scheme is registered with the Securities and Exchange Board of India [SEBI]

(ii) The Company had raised ₹100 Crores under the Scheme.

Referring to and analysing the provisions of the Securities and Exchange Board of India Act, 1992, decide:

(i) Whether the "Cash-down Payment Scheme" operated by ABC Limited is a Collective Investment Scheme.

(ii) What will be your answer in case the scheme is not registered with SEBI?

(4 Marks)

(b) 'SEBI has powers to pass cease and desist order'. Examine the statement with reference to the provisions of the Securities and Exchange Board of India Act, 1992. ***(4 Marks)***

(c) Mr. MGJ, a person resident outside India, is contemplating to invest his foreign currency funds through equity contribution in an Indian company engaged in a huge township development project consisting commercial and residential complex in Bangalore (India). Examine, referring to the provisions of the Foreign Exchange Management Act, 1999, the feasibility of his proposal of investing funds in the said company. ***(3 Marks)***

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(d) Upalayam Old Student Association was formed with the object of providing Coaching & Hostel facilities to the students studying in the government school. Mr. Murugan, an Indian Origin, acquired American citizenship and settled in USA. However, he is an overseas citizen of India cardholders. Mr. Murugan donated ₹ 10 Lakh to the said Association from his personal savings through the normal banking channel. Referring to the provisions of the Foreign Contribution (Regulation) Act, 2010, answer the following:

(i) Whether the donation made by Mr. Murugan is a foreign contribution?

(ii) What will be your answer in case Mr. Murugan still holds Indian Citizenship?

(3 Marks)

Answer

(a) **"Collective Investment Scheme"** means any scheme or arrangement which satisfies the conditions specified in Section 11AA of the Securities and Exchange Board of India, Act, 1992 [Section 2(1)(ba)]

Collective investment Scheme [Section 11AA]: Any scheme or arrangement which satisfies following conditions, shall be a collective investment scheme as specified in sub-section (2) or sub- section (2A).

Provided that any pooling of funds under any scheme or arrangement, which is not registered with the Board, involving a corpus amount of one hundred crore rupees or more, shall be deemed to be a collective investment scheme.

Requisite conditions [Section 11AA(2)]: Any scheme or arrangement made or offered by any person under which -

(i) the contributions, or payments made by the investors, by whatever name called, are pooled and utilized for the purposes of the scheme or arrangement;

(ii) the contributions or payments are made to such scheme or arrangement by the investors with a view to receive profits, income, produce or property, from such scheme or arrangement;

(iii) the property, contribution or investment forming part of scheme or arrangement, whether identifiable or not, is managed on behalf of the investors;

(iv) the investors do not have day-to-day control over the management and operation of the scheme or arrangement. [Sub-section 2]

Section 11AA(2A)· Any scheme or arrangement made or offered by any person satisfying the conditions as may be specified in accordance with the regulations made under this Act.

Accordingly, following shall be the answers:

(i) Yes, "Cash -down Payment Scheme" operated by ABC Limited is a Collective Investment Scheme in compliance with the requisite conditions and is registered with the SEBI.

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(ii) In the given case, if the Scheme is not registered with SEBI, then any pooling of funds under any scheme, involving a corpus amount of one hundred crore rupees or more, shall be deemed to be a Collective Investment Scheme.

Therefore, the answer will remain the same.

(b) According to Section 11D of the SEBI Act, 1992, if the Board finds, after causing an inquiry to be made, that any person-

(i) has violated, or

(ii) is likely to violate,

any provisions of this Act, or any rules or regulations made thereunder.

It may pass an order requiring such person to cease and desist from committing or causing such violation.

Provided that the Board shall not pass such order in respect of any listed public company or a public company (other than the intermediaries specified under section 12) which intends to get its securities listed on any recognised stock exchange unless the Board has reasonable grounds to believe that such Company has indulged in insider trading or market manipulation.

In view of the above, the statement that SEBI has powers to pass cease and desist order, is correct subject to the conditions provided in Section 11(D) of the SEBI Act. 1992.

(c) As per the Foreign Exchange Management (Permissible Capital Account Transactions) Regulations, 2000, a person resident outside India is prohibited from making investments in India in any form, in any Company, or partnership firm or proprietary concern or any entity whether incorporated or not which is engaged or proposes to engage in real estate business, or construction of farm houses.

Here the term "real estate business" shall not include development of townships, construction of residential /commercial premises, roads or bridges and Real Estate Investment Trusts (REITs) registered and regulated under the SEBI (REITs) Regulations 2014.

Conclusion: Accordingly, the proposal of investing funds in an Indian Company by Mr. MGJ, is feasible as the investment is for development of township as per the above stated laws.

(d) Foreign Contribution:

Foreign Contribution is defined under Section 2(1)(h) of the Foreign Contribution (Regulation) Act, 2010 (FCRA, 2010), to mean the donation, delivery or transfer made by any foreign source. Section 2(1)(j) only speaks about citizen of a foreign country while inclusively defining foreign source. A donation, delivery or transfer of any article, currency or foreign security by any person who has received it from any foreign source, either directly or through one or more persons is a foreign contribution.

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(i) Whether the donation made by Mr. Murugan is a Foreign Source? Yes. Donation from Mr. Murugan, a Person of Indian origin who has acquired American citizenship and also is an Overseas Citizen of India cardholder, will be treated as foreign contribution.

(ii) In case if Mr. Murugan still holds Indian Citizenship

Contributions made by a citizen of India living in another country i.e. 'Non-resident Indians' from his personal savings through normal banking channels is not to be treated as foreign contribution. In case if Mr. Murugan holds Indian citizenship, he is not a foreigner and therefore, donation given by Mr. Murugan, will not be treated as foreign contribution.

Question 5

(a) The following balances are extracted from the last audited financial statement of Blow (Nidhi) Limited.

Particulars	*Amount in ₹*
Paid up Equity Share capital	*15,00 000*
Paid up Preference Share Capital	*5,00,000*
Free Reserves	*1,00,000*
Tangible Assets	*10,00,000*
Intangible Assets	*2,00,000*

Referring to the Nidhi Rules, 2014, as amended from time to time, formulated under the Companies Act, 2013 answer the following:

(i) Compute the Net Owned Funds of Blow (Nidhi) Limited.

(ii) Compute the Maximum amount of deposits that Blow (Nidhi) Limited can accept.

(4 Marks)

(b) Anoor Sheep Private Limited, a small company, donated, One Lakh to a Political Party in the month of May 2021. The Company has been in existence for less than three financial years and it has, thus, contravened the provisions of Section 182 of the Companies Act 2013. Eventually, a fine of ₹5 Lakh, ignoring the legal status of the company, was imposed by the Adjudicating Officer (Registrar of Companies) on the Company. Anoor Sheep Private Limited approached the Registrar of Companies with a request to levy lesser penalties. Referring to the provisions of the Companies Act, 2013, answer the following:

(i) Is it possible to levy lesser penalty?

(ii) If so, compute the quantum of the penalty that will be payable by the Company.

(4 Marks)

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(c) Argunt Infrastructure Project Private Limited [Corporate Debtor] is classified as a Small Enterprise under Sub-section (1) of Section 7 of the Micro, Small and Medium Enterprises Development (27 of 2006) Act, 2006. It owes ₹ 60 Lakh to its creditors. In view of Covid-19 Pandemic situation, the Corporate Debtor was not in a position to recover money from Sundry Debtors as per the payment schedule and it commits default in settling dues to the Sundry Creditors. The Corporate Debtor decided to go for Pre-packed Insolvency Resolution Process [PPIRP] under the provisions of the Insolvency and Bankruptcy Code, 2016 (IBC) and accordingly took the following steps to initiate PPIRP.

1. The Financial Creditors of the Corporate Debtor, not being its related parties, representing 66% in value of the financial debt due to them proposed Mr. Pure, the Insolvency Professional, to be appointed as Resolution Professional to conduct PPIRP.

2. The Majority of the Board of Directors of the Corporate Debtor have made a declaration that the PPIRP is not being initiated to defraud any person and nothing more is contained in the declaration.

3. The Members of the Corporate Debtor passed an Ordinary Resolution approving the filing of an application for initiating PPIRP.

There were no further approvals obtained from the Financial Creditors / Board of Directors on any matters.

Referring to the provisions of the Insolvency and Bankruptcy Code 2016, advise on the following matters for filing of an application before NCLT to initiate PPIRP.

(i) Whether the act of Financial Creditors proposing the name of the Mr. Pure as Resolution Professional is valid?

(ii) Whether the declaration made by the Board is in accordance with the Provisions of the IBC?

(iii) Whether the resolution passed by the members of the company is in line with the requirements of the IBC?

(iv) Are there any requirements to get the approval of the Financial Creditors/ Board of Directors on any other matters? If so, state the relevant provisions of the IBC.

(6 Marks)

Answer

(a) (i) Computation of Net Owned Funds of Blow (Nidhi) Limited Provision

According to Rule 3 of the Nidhi Rules, 2014, "Net Owned Funds**"** means the aggregate of paid up equity share capital and free reserves as reduced by accumulated losses and intangible assets appearing in the last audited balance sheet.

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Provided that the amount representing the proceeds of issue of preference shares shall not be included for calculating Net Owned Funds.

Calculation

Particulars	Amount in ₹
Paid up Equity Share Capital	15,00,000
Free Reserves	1,00,000
Less: Intangible Assets	(2,00,000)
Net Owned Funds	**14,00,000**

(ii) Computation of maximum amount of deposits that Blow (Nidhi) Limited can accept According to Rule 11 of the Nidhi Rules, 2014, a Nidhi shall not accept deposits exceeding twenty times of its Net Owned Funds (NOF) as per its last audited financial statements.

Hence, Blow (Nidhl) Limited can accept maximum ₹ 2,80,00,000 (20 times of ₹ 14,00,000) as deposits.

(b) According to Section 446B of the Companies Act, 2013, if penalty is payable for non-compliance of any of the provisions of this Act by a One Person Company, Small Company, Start- up Company or Producer Company, or by any of its officer in default, or any other person in respect of such company, then such Company, its officer in default or any other person, as the case may be, shall be liable to a penalty which shall not be more than one-half of the penalty specified in such provisions subject to a maximum of two lakh rupees in case of a company and one lakh rupees in case of an officer who is in default or any other person, as the case may be.

Section 182 of the Companies Act, 2013, provides:

(1) a company which has been in existence for less than three financial years is not allowed to contribute to any political party

(2) if a company makes any contribution in contravention of the provisions of Section 182, he company shall be punishable with fine up to five times the amount of contribution so made.

In the light of the above provisions and facts of the question, the following are the answers

(i) Is it possible to levy Lesser Penalty?

Yes, it is possible to levy lesser penalty as Anoor Sheep Private Limited is a small company and section 446B provides for lesser penalty for small companies.

(ii) Computation of the Quantum of Penalty

Anoor Sheep Private Limited has contravened the provisions of section 182 and is liable to penalty (maximum 5 times of ₹ 1,00,000), however, it being a small company

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cannot be penalised for an amount exceeding ₹ 2,00,000 [(1/2 of ₹ 5,00,000) subject to a maximum of two lakh rupees].

(c) Pre-Packaged Insolvency Resolution Process (PPIRP) [Sections 54A - 54P of the Insolvency and Bankruptcy Code, 2016].

Corporate Debtors eligible for Pre-Packaged Insolvency Resolution Process

In terms of Section 54A(1) of the IBC,2016 an application for initiating PPIRP may be made in respect of a corporate debtor classified as a micro, small or medium enterprise under Section 7(1) of the Micro, Small and Medium Enterprises Development Act, 2006.

(i) Whether the Act of the Financial Creditors proposing the name of Mr. Pure as Resolution Professional is valid?

In terms of Section **54A(2)** of the IBC, 2016 an application for initiating PPIRP may be made in respect of a corporate debtor who commits default referred to in Section 4 subject to a condition specified in Section **54A2(e)** whereby, the financial creditors of the corporate debtor not being its related parties, representing such number and such manner as may be specified, have proposed the name of the insolvency professional to be appointed as resolution professional for conducting the PPIRP of the corporate debtor and the financial creditors of the corporate debtor not being its related parties representing not less than 66% in value of the financial debt due to such creditors have approved in such form as may be specified.

Therefore, In view of the above, the act of Financial Creditors proposing the name of Mr. Pure as Resolution Professional, is valid.

(ii) Whether the declarations made by the Board is in accordance with the provisions of IBC, 2016?

In terms of Section 54A(2)(f) of the IBC, 2016, the majority of the director or partners of the corporate debtor, as the case may be, have made a declaration, in such form as may be specified stating that:

(i) That the corporate debtor shall file an application for initiating PPIRP within a definite time period of 90 days,

(ii) That the PPIRP is not being initiated to defraud any person.

(iii) The name of the insolvency professional proposed and approved to be appointed as resolution professional under clause (e).

In view of the above, the only declaration by the majority of Board of Directors of the Corporate Debtor that the PPIRP is not being initiated to defraud any person, is not sufficient. The declaration shall also contain the matters contained in Clause 2(f)(i) and (iii) above.

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(iii) Whether the resolution passed by members is in line with the requirements of IBC, 2016?

No. The Act requires that the members of the corporate debtor to pass a special resolution, or at least three-fourth of the total number of partners, as the case may be, of the corporate debtor have passed a resolution approving the filing of an application for initiating pre-packaged insolvency resolution process.

(iv) Requirements to get the approval of Financial Creditors / Board of Directors

Yes. The corporate debtor shall obtain an approval from its financial creditors, representing at least sixty-six per cent. in value of the financial debt due to such creditors, for the filing of an application for initiating pre-packaged insolvency resolution process.

By majority of the directors of the corporate debtor, a declaration is required on stating that the corporate debtor shall file an application for initiating pre-packaged insolvency resolution process within a definite time period not exceeding ninety days; and the name of the insolvency professional proposed and approved to be appointed as resolution professional.

Question 6

(a) A, B and C are independent directors of X Limited. A was appointed independent director for a period of 3 years, B was appointed for a period of 5 years and C was appointed for a second term of 5 years.

The period /term of all the independent directors will be over on 30th September, 2022. X Limited is planning to consider reappointment of the above independent directors. You are requested to advice whether A, B and C can be reappointed as independent directors as per the provisions of the Companies Act, 2013? ***(4 Marks)***

OR

Mr. Jack, a young and energetic 24 years old American Citizen came to India in the month of January, 2021 for taking up employment. He has been hunting for the job and stayed in India. M/s NS Software Solutions Limited is a listed company engaged in developing customized software package for automobile manufacture. This company appointed Mr. Jack as its Managing Director at the Annual General Meeting held on 11th November, 2021, upon certain terms & conditions. Based on the above information, you are requested to validate the following referring to the provisions of the Companies Act, 2013 read with Schedule V of the Act:

(i) Eligibility of Mr. Jack for being appointed as a managing director.

(ii) Will your answer differ in case the company is located in Special Economic Zone. (SEZ)?

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(b) *ABC Limited put forth the following matters for your examination. The meeting of the Board of Directors of the company was convened on 15th July, 2021. While one Director attended the Board Meeting physically all other five Directors of the Company attended the meeting through Video conferencing /other Audio-visual means and approved the Annual Financial Statements ending 31st March, 2021. Referring to the provisions of the Companies Act, 2013 you are requested to validate the followings:*

(i) Compliance requirement of quorum for the said meeting.

(ii) Approval of the Financial Statements for the year ending 31st March, 2021.

(4 Marks)

(c) *XYZ Private Limited is a Start-up company recognized by the Central Government. The company is intending to raise External Commercial Borrowing under automatic route of USD 3 million for 3 years in the form of partially convertible preference shares for working capital from one of the shareholders.*

You are requested to advice the company on the Maturity, Forms and Amount of External Commercial Borrowing permitted as per the provisions of the Foreign Exchange Management Act, 1999. ***(3 Marks)***

(d) *Ram, the financial creditor, was an investor and a debenture holder of 'Optionally Convertible Debenture Bond (OCDB)' payable on maturity with redemption premium, issued by Asset Limited (Corporate Debtor). The zero interest OCDB bonds amounted to ₹ 3 Crore was matured in 2016. The Corporate Debtor failed to discharge this liability in due date. Ram filed an application to initiate the Corporate Insolvency Resolution Process (CIRP) before the NCLT. Advise, in the light of the given facts, the following situations referring to the provisions of the Insolvency and Bankruptcy Code, 2016:*

(i) Whether Ram is eligible for filing an application for initiation of CIRP?

(ii) Whether the redemption of debenture bonds, payable on the maturity date, amounts to debt? ***(3 Marks)***

Answer

(a) According to Section 149(10) & (11) of the Companies Act, 2013:

Term: an independent director shall hold office for a term up to 5 consecutive years on the Board of a company.

Eligibility for Re-appointment: He shall be eligible for re-appointment on passing of a special resolution by the company and disclosure of such appointment in the Board's report.

Limit on holding of office: An independent director shall not hold office for more than 2 consecutive terms.

Cooling period for appointment: However, he shall be eligible for appointment after the expiration of 3 years of ceasing to be an independent director.

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Appointment of A

In the instant case, A was appointed Independent Director for a period of 3 years, therefore he can be re-appointed after complying the above provisions.

Appointment of B and C

B was appointed for a period of 5 years, therefore he can also be re-appointed after complying the above provisions.

C was appointed for a second term of 5 years, he cannot be reappointed as Independent Director for consecutive third term. However, he shall be eligible for appointment after the expiration of 3 years of ceasing to be an independent director.

OR

Additional eligibility conditions for appointment as per Schedule V:

Part I **of Schedule V** to the Companies Act, 2013, has prescribed additional eligibility conditions for appointment as Managing Director or whole-time director or a manager without seeking approval from the Central Government. According to condition (4), the person to be appointed shall be resident of India.

Explanation *I* clarifies that **resident in India** includes a person who has been staying in India for a continuous period of not less than twelve months immediately preceding the date of his appointment as a managerial person and who has come to stay in India, -

(a) for taking up employment in India; or

(b) for carrying on a business or vocation in India.

Explanation *II* clarifies that the condition above shall not apply to the companies in Special Economic Zones (SEZ).

(i) Eligibility of Mr. Jack for being appointed as the MD

In the instant case, Mr. Jack, an American Citizen came to India in the month of January, 2021 for taking up employment. He has been appointed as Managing Director in NS Software Solutions Limited on 11th November, 2021.

Since, Mr. Jack has not stayed in India for a continuous period of twelve months immediately preceding 11th November, 2021, he is not eligible for being appointed as the Managing Director.

(ii) If the Company is located in SEZ

In case the Company is located in Special Economic Zone (SEZ), the above condition shall not apply and Mr. Jack is eligible for being appointed as a Managing Director.

(b) According to Section 174(1) of the Companies Act, 2013, the quorum for a Board Meeting shall be one-third of its total strength or two directors, whichever is higher.

Also, Section 173(2) of the Act allows the directors of a Company to attend Board meetings

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in the following manner:

- in person
- through video conferencing
- other Companies audio-visual (Meetings means of as prescribed Board and under its Rule 3 Powers) of the Rules, 2014

(i) Quorum Compliance

In the instant case, since there are total 6 directors in ABC Limited, the quorum shall be 2 (1/3rd of 6 or 2, whichever is higher). Since, one director attended the meeting physically and all other five directors attended through Video conferencing/ Audio visual means, it implies that all the directors attended the meeting and quorum compliance is there.

(ii) Approval of Financial Statements:

Since the quorum of the Board meeting is complied with the presence of all the six directors, therefore, approval of Financial Statement in the Board Meeting held on 15th July, 2021 is valid.

Further, according to Rule 4 of the Companies (Meetings of Board and its Powers) Rules, 2014, certain matters including the approval of Annual Financial Statements cannot be dealt with in a meeting through Video Conferencing / Other Audio visual means. However, vide **Notification GSR** Powers) Rules, 2014, through enforcement of the Companies (Meeting of Board and its Powers) Rules, 2014, Rule 4 dealing with matters to be dealt with in a meeting through video conferencing or other audio visual means was omitted. Therefore, the Company has compiled with the provisions of the Companies Act, 2013 approving the Annual Financial Statements at the Board Meeting held on 15th July, 2021.

(c) XYZ Limited, based on the guidelines contained in the Master Direction No 5/2018 - 19 issued by the Reserve Bank of India, is advised as under**:**

ECB facility for Start-ups: AD Category-I Banks are permitted to allow Start-ups to raise ECB under the automatic route as per the following framework:

Eligibility: An entity recognized as a Start-up by the Central Government as on date of raising ECB. Maturity: Minimum average maturity period will be 3 years.

Forms: The borrowing can be in form of loans or non-convertible, optionally convertible or part I convertible preference shares.

Amount of ECB: The borrowing per Start-up will be limited to USD 3 million or equivalent per financial year either in INR or any convertible foreign currency or a combination of both.

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(d) **Optionally Convertible Debenture Bonds (OCDB)** are debt securities which allow an issuer to raise capital and in return the issuer pays interest to the investor till the maturity.

(i) Whether Ram is eligible to file an application for initiation of CIRP?

In the given case, Ram, was a debenture holder of OCDB payable on maturity issued by Asset Limited (Corporate Debtor), which it failed to discharge on due date.

According to Section 21(6A), where a financial debt is in the form of securities or deposits and the terms of the financial debt provide for appointment of a trustee or agent to act as authorised representative for all the financial creditors, such trustee or agent shall act on behalf of such financial creditors;

According to the proviso to Section 7 of the Code, an application for initiating corporate insolvency resolution process against the corporate debtor shall be filed jointly by required number of such creditors in the same class as specified, through such authorised representative i.e. trustee or agent.

Accordingly, Mr. Ram is entitled for filing an application for initiation of CIRP.

(ii) Whether the redemption of debenture bonds, payable on the maturity date amounts to debt?

Yes, Redemption of debenture bonds, payable on maturity amounts to debt. Debt under the Code means a liability or obligation in respect of a claim which is due from any person and includes a financial debt and operational debt. [Section 3(11)]

Financial Debt - "Financial debt" means a debt along with interest, if any, which is disbursed against the consideration for the time value of money and includes any amount raised pursuant to any note purchase facility or the issue of bonds, notes, debentures, loan stock or any similar instrument.

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