PAPER –1: FINANCIAL REPORTING

QUESTIONS

Analysis of Financial Statements/ Ind AS 101

1. HIM Limited having net worth of ₹ 250 crores is required to adopt Ind AS from 1 April, 20X2 in accordance with the Companies (Indian Accounting Standard) Rules 2015.

   Rahul, the senior manager, of HIM Ltd. has identified following issues which need specific attention of CFO so that opening Ind AS balance sheet as on the date of transition can be prepared:

   Issue 1 : As part of Property, Plant and Equipment, Company has elected to measure land at its fair value and want to use this fair value as deemed cost on the date of transition. The carrying value of land as on the date of transition was ₹ 5,00,000. The land was acquired for a consideration of ₹ 5,00,000. However, the fair value of land as on the date of transition was ₹ 8,00,000.

   Issue 2 : Under Ind AS, the Company has designated mutual funds as investments at fair value through profit or loss. The value of mutual funds as per previous GAAP was ₹ 4,00,000 (at cost). However, the fair value of mutual funds as on the date of transition was ₹ 5,00,000.

   Issue 3 : Company had taken a loan from another entity. The loan carries an interest rate of 7% and it had incurred certain transaction costs while obtaining the same. It was carried at cost on its initial recognition. The principal amount is to be repaid in equal instalments over the period of loan. Interest is also payable at each year end. The fair value of loan as on the date of transition is ₹ 1,80,000 as against the carrying amount of loan which at present equals ₹ 2,00,000.

   Issue 4 : The company has declared dividend of ₹ 30,000 for last financial year. On the date of transition, the declared dividend has already been deducted by the accountant from the company's 'Reserves & Surplus' and the dividend payable has been grouped under 'Provisions'. The dividend was only declared by board of directors at that time and it was not approved in the annual general meeting of shareholders. However, subsequently when the meeting was held it was ratified by the shareholders.

   Issue 5 : The company had acquired intangible assets as trademarks amounting to ₹ 2,50,000. The company assumes to have indefinite life of these assets. The fair value of the intangible assets as on the date of transition was ₹ 3,00,000. However, the company wants to carry the intangible assets at ₹ 2,50,000 only.

   Issue 6 : After consideration of possible effects as per Ind AS, the deferred tax impact is computed as ₹ 25,000. This amount will further increase the portion of deferred tax liability. There is no requirement to carry out the separate calculation of deferred tax on account of Ind AS adjustments.

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Management wants to know the impact of Ind AS in the financial statements of company for its general understanding.

Prepare Ind AS Impact Analysis Report (Extract) for HIM Limited for presentation to the management wherein you are required to discuss the corresponding differences between Earlier IGAAP (AS) and Ind AS against each identified issue for preparation of transition date balance sheet. Also pass journal entry for each issue.

Ind AS 2

2. On 1 January 20X1 an entity accepted an order for 7,000 custom-made corporate gifts.

On 3 January 20X1 the entity purchased raw materials to be consumed in the production process for ₹ 5,50,000, including ₹ 50,000 refundable purchase taxes. The purchase price was funded by raising a loan of ₹ 5,55,000 (including ₹ 5,000 loan-raising fees). The loan is secured by the inventories.

During January 20X1 the entity designed the corporate gifts for the customer.

Design costs included:

- cost of external designer = ₹ 7,000; and
- labour = ₹ 3,000.

During February 20X1 the entity's production team developed the manufacturing technique and made further modifications necessary to bring the inventories to the conditions specified in the agreement. The following costs were incurred in the testing phase:

- materials, net of ₹ 3,000 recovered from the sale of the scrapped output = ₹ 21,000;
- labour = ₹ 11,000; and
- depreciation of plant used to perform the modifications = ₹ 5,000.

During February 20X1 the entity incurred the following additional costs in manufacturing the customised corporate gifts:

- consumable stores = ₹ 55,000;
- labour = ₹ 65,000; and
- depreciation of plant used to manufacture the customised corporate gifts = ₹ 15,000.

The customised corporate gifts were ready for sale on 1 March 20X1. No abnormal wastage occurred in the development and manufacture of the corporate gifts.

Compute the cost of the inventory? Substantiate your answer with appropriate reasons and calculations, wherever required.

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Ind AS 8

3. In 20X3-20X4, after the entity's 31 March 20X3 annual financial statements were approved for issue, a latent defect in the composition of a new product manufactured by the entity was discovered (that is, a defect that could not be discovered by reasonable or customary inspection). As a result of the latent defect the entity incurred ₹100,000 in unanticipated costs for fulfilling its warranty obligation in respect of sales made before 31 March 20X3. An additional ₹20,000 was incurred to rectify the latent defect in products sold during 20X3-20X4 before the defect was detected and the production process rectified, ₹5,000 of which relates to items of inventory at 31 March 20X3. The defective inventory was reported at cost ₹ 15,000 in the 20X2-20X3 financial statements when its selling price less costs to complete and sell was estimated at ₹18,000. The accounting estimates made in preparing the 31 March 20X3 financial statements were appropriately made using all reliable information that the entity could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

   Analyse the above situation in accordance with relevant Ind AS.

Ind AS 38

4. PQR Ltd. is a gaming developer company. Few years back, it developed a new game called 'Cloud9'. This game sold over 10,00,000 copies around the world and was extremely profitable. Due to its popularity, PQR Ltd. released a new game in the 'Cloud9' series every year. The games continue to be the bestseller. Based on Management's expectations, estimates of cash flow projections for the 'cloud9 videogame series' over the next five years have been prepared. Based on these projections, PQR Ltd. believes that cloud9 series brand should be recognised at INR 20,00,000 in its financial statement. PQR Ltd. has also paid INR 10,00,000 to MNC Ltd. to acquire rights of another video game series called the 'Headspace' videogame series. The said series have huge demand in the market.

   Discuss the accounting treatment of the above in the financial statements of PQR Ltd.

Ind AS 37 / Ind AS 115

5. A manufacturer gives warranties to the purchasers of its goods. Under the terms of the warranty, the manufacturer undertakes to make good, by repair or replacement, manufacturing defects that become apparent within three years from the date of sale to the purchasers.

   On 30 April 20X1, a manufacturing defect was detected in the goods manufactured by the entity between 1 March 20X1 and 30 April 20X1.

   At 31 March 20X1 (the entity's reporting date), the entity held approximately one week's sales in inventories.

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The entity's financial statements for the year ended 31 March 20X1 have not yet been finalised.

Three separate categories of goods require separate consideration:

Category 1—defective goods sold on or before 31 March 20X1

Category 2—defective goods held on 31 March 20X1

Category 3—defective goods manufactured in 20X1-20X2

State the accounting treatment of the above categories in accordance with relevant Ind AS.

Ind AS 16

6. An entity has the following items of property, plant and equipment:

   - Property A — a vacant plot of land on which it intends to construct its new administration headquarters;
   - Property B — a plot of land that it operates as a landfill site;
   - Property C — a plot of land on which its existing administration headquarters are built;
   - Property D — a plot of land on which its direct sales office is built;
   - Properties E1–E10 — ten separate retail outlets and the land on which they are built;
   - Equipment A — computer systems at its headquarters and direct sales office that are integrated with the point of sale computer systems in the retail outlets;
   - Equipment B — point of sale computer systems in each of its retail outlets;
   - Furniture and fittings in its administrative headquarters and its sales office;
   - Shop fixtures and fittings in its retail outlets.

   How many classes of property, plant and equipment must the entity disclose?

Ind AS 23 / Ind AS 109

7. How will you capitalise the interest when qualifying assets are funded by borrowings in the nature of bonds that are issued at discount?

   Y Ltd. issued at the start of year 1, 10% (interest paid annually and having maturity period of 4 years) bonds with a face value of ₹ 2,00,000 at a discount of 10% to finance a qualifying asset which is ready for intended use at the end of year 2.

   Compute the amount of borrowing costs to be capitalized if the company amortizes discount using Effective Interest Rate method by applying 13.39% p.a. of EIR.

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Ind AS 7

8. From the following data, identify the nature of activities as per Ind AS 7.

S.no.	Nature of transaction
1	Cash paid to employees
2	Cash paid for development of property costs
3	Borrowings repaid
4	Cash paid to suppliers
5	Loan to Director
6	Bonus shares issued
7	Dividends paid
8	Cash received from trade receivables
9	Proceeds from sale of PPE
10	Depreciation of PPE
11	Advance received from customers
12	Purchased goodwill
13	Payment of promissory notes

Ind AS 40

9. X Ltd owned a land property whose future use was not determined as at 31 March 20X1. How should the property be classified in the books of X Ltd as at 31 March 20X1?

   During June 20X1, X Ltd commenced construction of office building on it for own use. Presuming that the construction of the office building will still be in progress as at 31 March 20X2

   (a) How should the land property be classified by X Ltd in its financial statements as at 31 March 20X2?

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

   (c) 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?

   (d) Would your answer to (a) 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 31 March 20X2?

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Ind AS 115

10. A property sale contract includes the following:
    (a) Common areas
    (b) Construction services and building material
    (c) Property management services
    (d) Golf membership
    (e) Car park
    (f) Land entitlement

    Analyse whether the above items can be considered as separate performance obligations as per the requirements of Ind AS 115?

Ind AS 116

11. Entity X is an Indian entity whose functional currency is Indian Rupee. It has taken a plant on lease from Entity Y for 5 years to use in its manufacturing process for which it has to pay annual rentals in arrears of USD 10,000 every year. On the commencement date, exchange rate was USD = ₹ 68. The average rate for Year 1 was ₹ 69 and at the end of year 1, the exchange rate was ₹ 70. The incremental borrowing rate of Entity X on commencement of the lease for a USD borrowing was 5% p.a.

    How will entity X measure the right of use (ROU) asset and lease liability initially and at the end of Year 1?

Ind AS 102

12. Company P is a holding company for company B. A group share-based payment is being organized in which Parent issues its own equity shares to the employees of company B. The details are as below –

Number of Employees of Company B	100
Grant date fair value of share	₹ 87
Number of shares granted to each employee	25
Vesting conditions	Immediately
Face value per share	₹ 10

Pass the journal entries in the books of company P & company B.

Ind AS 103

13. Bima Ltd. acquired 65% of shares on 1 June, 20X1 in Nafa Ltd. which is engaged in production of components of machinery. Nafa Ltd. has 1,00,000 equity shares of ₹ 10 each. The quoted market price of shares of Nafa Ltd. was ₹ 12 on the date of

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acquisition. The fair value of Nafa Ltd.'s identifiable net assets as on 1 June, 20X1 was ₹ 80,00,000.

Bima Ltd. wired ₹ 50,00,000 in cash and issued 50,000 equity shares as purchase consideration on the date of acquisition. The quoted market price of shares of Bima Ltd. on the date of issue was ₹ 25 per share.

Bima Ltd. also agrees to pay additional consideration of ₹ 15,00,000, if the cumulative profit earned by Nafa Ltd. exceeds ₹ 1 crore over the next three years. On the date of acquisition, Nafa Ltd. assessed and determined that it is considered probable that the extra consideration will be paid. The fair value of this consideration on the date of acquisition is ₹ 9,80,000. Nafa Ltd. incurred ₹ 1,50,000 in relation to the acquisition. It measures Non-controlling interest at fair value.

How will the acquisition of Nafa Ltd. be accounted by Bima Ltd., under Ind AS 103? Prepare detailed workings and pass the necessary journal entry.

Ind AS 41

14. Analyse whether the following activities fall within the scope of Ind AS 41 with proper reasoning:

    - Managing animal-related recreational activities like Zoo
    - Fishing in the ocean
    - Fish farming
    - Development of living organisms such as cells, bacteria and viruses
    - Growing of plants to be used in the production of drugs
    - Purchase of 25 dogs for security purpose of the company's premises.

Ind AS 109

15. On 1 April 20X1, Sun Limited guarantees a ₹10,00,000 loan of Subsidiary – Moon Limited, which Bank STDK has provided to Moon Limited for three years at 8%.

    Interest payments are made at the end of each year and the principal is repaid at the end of the loan term.

    If Sun Limited had not issued a guarantee, Bank STDK would have charged Moon Limited an interest rate of 11%. Sun Limited does not charge Moon Limited for providing the guarantee.

    On 31 March 20X2, there is 1% probability that Moon Limited may default on the loan in the next 12 months. If Moon Limited defaults on the loan, Sun Limited does not expect to recover any amount from Moon Limited.

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On 31 March 20X3, there is 3% probability that Moon Limited may default on the loan in the next 12 months. If Moon Limited defaults on the loan, Sun Limited does not expect to recover any amount from Moon Limited.

Provide the accounting treatment of financial guarantee as per Ind AS 109 in the books of Sun Ltd., on initial recognition and in subsequent periods till 31 March 20X3.

Ind AS 1

16. An entity has the following trial balance line items. How should these items be classified, i.e., current or non-current as per Ind AS 1?

    (a) Receivables (viz., receivable under a contract of sale of goods in which an entity deals)

    (b) Advance to suppliers

    (c) Income tax receivables [other than deferred tax]

    (d) Insurance spares

Ind AS 21 & Ind AS 103

17. Monsoon Limited acquired, on 30 September, 20X2, 70% of the share capital of Mark Limited, an entity registered as company in Germany. The functional currency of Monsoon Limited is Indian Rupee and its financial year ends on 31 March, 20X3.

    The fair value of the net assets of Mark Limited was 23 million EURO and the purchase consideration paid is 17.5 million EURO on 30 September, 20X2.

    The exchange rates as on 30 September, 20X2 was ₹ 82 per EURO and at 31 March, 20X3 was ₹ 84 per EURO.

    On acquisition of Mark limited, what is the value at which the goodwill / capital reserve has to be recognized in the financial statements of Monsoon Limited as on 31 March 20X3?

Ind AS 19

18. At 1 April, 20X0, the fair value of the Plan Assets was ₹ 10,00,000. The Plan paid benefits of ₹ 1,90,000 and received contributions of ₹ 4,90,000 on 30 September, 20X0. The company computes the Fair Value of Plan Assets to be ₹ 15,00,000 as on 31 March, 20X1 and the Present Value of the Defined Benefit Obligation to amount to ₹ 14,79,200 on the same date. Actuarial losses on defined benefit obligation were ₹ 6,000.

    Compounding happens half-yearly. The normal interest rate for 6 months period is 10%, while the effective interest rate for 12 months period is based on the following data:

    At 1 April, 20X0, the company made the following estimates based on market prices at that date:

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Particulars	%
Interest and Dividend Income, after tax payable by the fund	9.25
Add: Realized and Unrealized Gains on Plan Assets (after tax)	2.00
Less: Administration Costs	(1.00)
Expected Rate of Return	10.25

Determine actual return and expected return on plan asset. Also compute amount to be recognized in 'Other Comprehensive Income' in this case.

Ind AS 12

19. The entity has an identifiable asset ASSOTA with a carrying amount of ₹ 10,00,000. Its recoverable amount is ₹ 6,50,000. The tax base of ASSOTA is ₹ 8,00,000 and the tax rate is 30%. Impairment losses are not tax deductible. Entity expects to continue to earn profits in future.

    For the identifiable asset ASSOTA, what would be the impact on the deferred tax asset/ liability at the end of the period?

Ind AS 36

20. On 31 March 20X1, Vision Ltd acquired 80% of the equity shares of Mission Ltd for ₹ 190 million. The fair values of the net assets of Mission Ltd that were included in the consolidated statement of financial position of Vision Ltd at 31 March 20X1 were ₹ 200 million. It is the Group's policy to value the non-controlling interest in subsidiaries at the date of acquisition at its proportionate share of the fair value of the subsidiaries' identifiable net assets.

    On 31 March 20X4, Vision Ltd carried out its annual review of the goodwill on consolidation of Mission Ltd and found evidence of impairment. No impairment had been evident when the reviews were carried out at 31 March 20X2 and 31 March 20X3. The review involved allocating the assets of Mission Ltd into three cash-generating units and computing the value in use of each unit. The carrying values of the individual units before any impairment adjustments are given below:

	Unit A ₹ in million	Unit B ₹ in million	Unit C ₹ in million
Intangible assets	30	10	-
Property, Plant and Equipment	80	50	60
Current Assets	60	30	40
Total	170	90	100
Value in use of unit	180	66	104

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It was not possible to meaningfully allocate the goodwill on consolidation to the individual cash generating units but all the other net assets of Mission Ltd are allocated in the table shown above.

The intangible assets of Mission Ltd have no ascertainable market value but all the current assets have a market value that is at least equal to their carrying value. The value in use of Mission Ltd as a single cash-generating unit on 31 March 20X4 is ₹ 350 million.

Discuss and compute the accounting treatment of impairment of goodwill as per Ind AS 36?

SUGGESTED ANSWERS

1. Preliminary Impact Assessment on Transition to Ind AS in HIM Limited's Financial Statements

Issue 1: Fair value as deemed cost for property plant and equipment:

Accounting Standards (Erstwhile IGAAP)	Ind AS	Impact on Company's financial statements
As per AS 10, Property, Plant and Equipment is recognised at cost less depreciation.	Ind AS 101 allows entity to elect to measure Property, Plant and Equipment on the transition date at its fair value or previous GAAP carrying value (book value) as deemed cost.	The company has decided to adopt fair value as deemed cost in this case. Since fair value exceeds book value, so the book value should be brought up to fair value. The resulting impact of fair valuation of land ₹ 3,00,000 should be adjusted in other equity.

Journal Entry on the date of transition

Particulars	Debit (₹)	Credit (₹)
Property Plant and Equipment Dr.	3,00,000	
To Revaluation Surplus (OCI- Other Equity)		3,00,000

Issue 2: Fair valuation of Financial Assets:

Accounting Standards (Erstwhile IGAAP)	Ind AS	Impact on Company's financial statements
As per Accounting Standard, investments	On transition, financial assets including	All financial assets (other than Investment in

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are measured at lower of cost and fair value.	investments are measured at fair values except for investments in subsidiaries, associates and JVs' which are recorded at cost.	subsidiaries, associates and JVs' which are recorded at cost) are initially recognized at fair value. The subsequent measurement of such assets are based on its categorization either Fair Value through Profit & Loss (FVTPL) or Fair Value through Other Comprehensive Income (FVTOCI) or at Amortised Cost based on business model assessment and contractual cash flow characteristics. Since investment in mutual fund are designated at FVTPL, increase of ₹ 1,00,000 in mutual funds fair value would increase the value of investments with corresponding increase to Retained Earnings.

Journal Entry on the date of transition

Particulars	Debit (₹)	Credit (₹)
Investment in mutual funds Dr.	1,00,000	
To Retained earnings		1,00,000

Issue 3: Borrowings - Processing fees/transaction cost:

Accounting Standards (Erstwhile IGAAP)	Ind AS	Impact on Company's financial statements
As per AS, such expenditure is charged to Profit and loss account or capitalised	As per Ind AS, such expenditure is amortised over the period of the loan. Ind AS 101 states that if it	Fair value as on the date of transition is ₹ 1,80,000 as against its book value of ₹ 2,00,000. Accordingly,

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as the case may be	is impracticable for an entity to apply retrospectively the effective interest method in Ind AS 109, the fair value of the financial asset or the financial liability at the date of transition to Ind AS shall be the new gross carrying amount of that financial asset or the new amortised cost of that financial liability.	the difference of ₹ 20,000 is adjusted through retained earnings.

Journal Entry on the date of transition

Particulars	Debit (₹)	Credit (₹)
Borrowings / Loan payable Dr.	20,000	
To Retained earnings		20,000

Issue 4: Proposed dividend:

Accounting Standards (Erstwhile IGAAP)	**Ind AS**	**Impact on Company's financial statements**
As per AS, provision for proposed divided is made in the year when it has been declared and approved.	As per Ind AS, liability for proposed dividend is recognised in the year in which it has been declared and approved.	Since dividend should be deducted from retained earnings during the year when it has been declared and approved. Therefore, the provision declared for preceding year should be reversed (to rectify the wrong entry). Retained earnings would increase proportionately due to such adjustment

Journal Entry on the date of transition

Particulars	Debit (₹)	Credit (₹)
Provisions Dr.	30,000	
To Retained earnings		30,000

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Issue 5 : Intangible assets:

Accounting Standards (Erstwhile IGAAP)	**Ind AS**	**Impact on Company's financial statements**
The useful life of an intangible asset cannot be indefinite under IGAAP principles. The Company amortised brand/trademark on a straight line basis over maximum of 10 years as per AS 26.	The useful life of an intangible asset like brand/trademark can be indefinite. Not required to be amortised and only tested for impairment. Company can avail the exemption given in Ind AS 101 as on the date of transition to use the carrying value as per previous GAAP.	Consequently, there would be no impact as on the date of transition since company intends to use the carrying amount instead of book value at the date of transition.

Issue 6: Deferred tax

Accounting Standards (Erstwhile IGAAP)	**Ind AS**	**Impact on Company's financial statements**
As per AS, deferred taxes are accounted as per income statement approach.	As per Ind AS, deferred taxes are accounted as per balance sheet approach.	On date of transition to Ind AS, deferred tax liability would be increased by ₹ 25,000.

Journal Entry on the date of transition

Particulars		Debit (₹)	Credit (₹)
Retained earnings	Dr.	25,000	
To Deferred tax liability			25,000

2. Statement showing computation of inventory cost

Particulars	**Amount (₹)**	**Remarks**
Costs of purchase	5,00,000	Purchase price of raw material [purchase price (₹ 5,50,000) less refundable purchase taxes (₹ 50,000)]
Loan-raising fee	–	Included in the measurement of the liability

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Costs of purchase	55,000	Purchase price of consumable stores
Costs of conversion	65,000	Direct costs—labour
Production overheads	15,000	Fixed costs—depreciation
Production overheads	10,000	Product design costs and labour cost for specific customer
Other costs	37,000	Refer working note
Borrowing costs	–	Recognised as an expense in profit or loss
Total cost of inventories	**6,82,000**	

Working Note:

Costs of testing product designed for specific customer:

₹ 21,000 material (ie net of the ₹ 3,000 recovered from the sale of the scrapped output) + ₹ 11,000 labour + ₹ 5,000 depreciation.

3. Ind AS 8 is applied in selecting and applying accounting policies, and accounting for changes in accounting policies, changes in accounting estimates and corrections of prior period errors.

A change in accounting estimate is an adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset. This change in accounting estimate is an outcome of the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities. Changes in accounting estimates result from new information or new developments and, accordingly, are not corrections of errors.

Further, the effect of change in an accounting estimate, shall be recognised prospectively by including it in profit or loss in: (a) the period of the change, if the change affects that period only; or (b) the period of the change and future periods, if the change affects both.

Prior period errors are omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:

(a) was available when financial statements for those periods were approved for issue; and

(b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.

On the basis of above provisions, the given situation would be dealt as follows:

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The defect was neither known nor reasonably possible to detect at 31 March 20X3 or before the financial statements were approved for issue, so understatement of the warranty provision ₹ 1,00,000 and overstatement of inventory ₹ 2,000 (Note 1) in the 31 March 20X3 financial statements are not a prior period errors.

The effects of the latent defect that relate to the entity's financial position at 31 March 20X3 are changes in accounting estimates.

In preparing its financial statements for 31 March 20X3, the entity made the warranty provision and inventory valuation appropriately using all reliable information that the entity could reasonably be expected to have obtained and had taken into account the same in the preparation and presentation of those financial statements.

Consequently, the additional costs are expensed in calculating profit or loss for 20X3-20X4.

Working Note:

Inventory is measured at the lower of cost (ie ₹ 15,000) and fair value less costs to complete and sell (ie ₹ 18,000 originally estimated minus ₹ 5,000 costs to rectify latent defect) = ₹ 13,000.

4. In order to determine the accounting treatment of 'cloud9 videogame series' and 'Headspace', definition of asset and intangible asset given in Ind AS 38 may be noted:

"An asset is a resource:

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

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

"An intangible asset is an identifiable non-monetary asset without physical substance."

In accordance with the above, for recognising an intangible asset, an entity must be able to demonstrate that the item satisfies the criteria of identifiability, control and existence of future economic benefits.

In order to determine whether 'cloud9 videogame series' meet the aforesaid conditions, following provisions of Ind AS 38 regarding Internally Generated Intangible Assets may be noted:

As per paragraph 63 and 64 of Ind AS 38, internally generated brands, mastheads, publishing titles, customer lists and items similar in substance should not be recognised as intangible assets. Expenditure on such items cannot be distinguished from the cost of developing the business as a whole. Therefore, such items are not recognised as intangible assets.

Accordingly, though the cash flow projections suggest that the cloud9 brand will lead to future economic benefits, yet the asset has been internally generated; therefore, the Cloud9 brand cannot be recognised as intangible asset in the financial statements.

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In order to determine whether 'Headspace' meet the aforesaid conditions, following provisions of Ind AS 38 regarding 'Separately acquired Intangible Assets' should be analused.

As per paragraphs 25 and 26 of Ind AS 38, normally, the price an entity pays to acquire separately an intangible asset will reflect expectations about the probability that the expected future economic benefits embodied in the asset will flow to the entity. In other words, the entity expects there to be an inflow of economic benefits, even if there is uncertainty about the timing or the amount of the inflow. Therefore, the probability recognition criterion in paragraph 21(a) is always considered to be satisfied for separately acquired intangible assets. In addition, the cost of a separately acquired intangible asset can usually be measured reliably. This is particularly so when the purchase consideration is in the form of cash or other monetary assets.

The Headspace game has been purchased for INR 10,00,000 and it is expected to generate future economic benefits to the entity. Since Headspace game is a separately acquired asset and the future benefits are expected to flow to the entity, therefore, an intangible asset should be recognised in respect of the 'Headspace' asset at its cost of INR 10,00,000. After initial recognition, either cost model or revaluation model can be used to measure headspace intangible asset as per guidance given in paragraphs 74-87 of Ind AS 38. In accordance with this, Headspace intangible asset should be carried at its cost/revalued amount (as the case may be) less any accumulated amortisation and any accumulated impairment losses.

5. **Category 1—defective goods sold on or before 31 March 20X1**

If customer has the option to purchase warranty separately, the warranty is a distinct service because the entity promises to provide the service to the customer in addition to the product that has the functionality described in the contract. In that case, entity shall account for the promised warranty as a performance obligation and allocate a portion of the transaction price to that performance obligation.

If a customer does not have the option to purchase a warranty separately, an entity shall account for the warranty in accordance with Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets,* unless it provides the customer with a service in addition to the assurance that the product complies with agreed-upon specifications. If that is the case, then, the promised service is a performance obligation. Entity shall allocate the transaction price to the product and the service.

If an entity promises both an assurance-type warranty and a service-type warranty but cannot reasonably account for them separately, the entity shall account for both of the warranties together as a single performance obligation.

A law that requires an entity to pay compensation if its products cause harm or damage does not give rise to a performance obligation. The entity shall account for such obligations in accordance with Ind AS 37.

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Category 2—defective goods held on 31 March 20X1

At 31 March 20X1 the entity did not have a present obligation to make good the unsold defective goods that it held in inventories. Accordingly, at 31 March 20X1 the entity should not recognise a provision in respect of the defective inventories. However, the entity should test the inventories for impairment in accordance with Ind AS 36, *Impairment of Assets*.

For this category, the detection of the manufacturing defect in April 20X1 is an adjusting event after the end of the reporting period as per Ind AS 10, *Events after the End of the Reporting Period*. It provides evidence of a manufacturing defect in inventories held at 31 March 20X1.

Category 3—defective goods manufactured in 20X1-20X2

At 31 March 20X1 the entity did not have a present obligation to make good any defective goods that it might manufacture in the future. Accordingly, at 31 March 20X1 the entity should not recognise a provision in respect of the defective goods manufactured in 20X1-20X2.

For this category, the detection of the manufacturing defect in April 20X1 is a non-adjusting event after the end of the reporting period as per Ind AS 10, *Events After the End of the Reporting Period*.

6. To answer this question one must make a materiality judgement.

A class of assets is defined as a grouping of assets of a similar nature and use in an entity's operations.

The nature of land without a building is different to the nature of land with a building.

Consequently, land without a building is a separate class of asset from land and buildings. Furthermore, the nature and use of land operated as a landfill site is different from vacant land. Hence, the entity should disclose Property A separately. The entity must apply judgement to determine whether the entity's retail outlets are sufficiently different in nature and use from its office buildings, and thus constitute a separate class of land and buildings.

The computer equipment is integrated across the organisation and would probably be classified as a single separate class of asset.

Furniture and fittings used for administrative purposes could be sufficiently different to shop fixtures and fittings in retail outlets. Hence, they should be classified in two separate classes of assets.

7. Capitalisation Method

As per the Standard, borrowing costs may include interest expense calculated using the effective interest method. Further, capitalisation of borrowing cost should cease where substantially all the activities necessary to prepare the qualifying asset for its intended

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use or sale are complete.

Thus, only that portion of the amortized discount should be capitalised as part of the cost of a qualifying asset which relates to the period during which acquisition, construction or production of the asset takes place.

Capitalisation of Interest

Hence based on the above explanation the amount of borrowing cost of year 1 & 2 are to be capitalised and the borrowing cost relating to year 3 & 4 should be expensed.

Quantum of Borrowing

The value of the bond to Y Ltd. is the transaction price ie ₹ 1,80,000 (2,00,000 – 20,000)

Therefore, Y Ltd will recognize the borrowing at ₹ 1,80,000.

Computation of the amount of Borrowing Cost to be Capitalised

Y Ltd will capitalise the interest (borrowing cost) using the effective interest rate of 13.39% for two years as the qualifying asset is ready for intended use at the end of the year 2, the details of which are as follows:

Year	*Opening Borrowing*	*Interest expense @ 13.39% to be capitalised*	*Total*	*Interest paid*	*Closing Borrowing*
	(1)	*(2)*	*(3)*	*(4)*	*(5) = (3) – (4)*
1	1,80,000	24,102	2,04,102	20,000	1,84,102
2	1,84,102	24,651	2,08,753	20,000	1,88,753
		48,753			

Accordingly, borrowing cost of ₹ 48,753 will be capitalized to the cost of qualifying asset.

8.

S. No.	Nature of transaction	Activity as per Ind AS 7
1	Cash paid to employees	Operating activity
2	Cash paid for development costs	Investing activity
3	Borrowings repaid	Financing activity
4	Cash paid to suppliers	Operating activity
5	Loan to Director	Investing activity
6	Bonus shares issued	Non-cash item
7	Dividends paid	Financing activity
8	Cash received from trade receivables	Operating activity
9	Proceeds from sale of PPE	Investing activity

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10	Depreciation of PPE	Non-cash item
11	Advance received from customers	Operating activity
12	Purchased goodwill	Investing activity
13	Payment of promissory notes	Financing activity

9. 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, in this case, the land would be regarded as held for capital appreciation. Hence the land property should be classified by X Ltd as investment property in the financial statements as at 31 March 20X1.

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 evidenced by a change in use. A change occurs when the property meets or ceases to meet the definition of investment property and there is evidence of the change in use. Mere management's intention for use of the property does not provide evidence of a change in use.

(a) Since X 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 31 March 20X2.

(b) As per Para 59, 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.

(c) 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 re-stated.

(d) Mere management intentions for use of the property do not evidence change in use. Since X Ltd has no plans to commence construction of the office building during 20X1-20X2, the property should continue to be classified as an investment property by X Ltd in its financial statements as at 31 March 20X2.

10. Paragraph 22 of Ind AS 115 provides that at contract inception, an entity evaluates the promised goods or services to determine which goods or services (or bundle of goods or services) are distinct and therefore constitute a performance obligation.

A performance obligation is a promise in a contract to transfer to the customer either:

- a good or service (or a bundle of goods or services) that is distinct; and
- series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

As per paragraph 27 of Ind AS 115, a good or service that is promised to a customer is distinct if both of the following criteria are met:

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(a) the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (i.e. the good or service is capable of being distinct); and

(b) the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (i.e. the promise to transfer the good or service is distinct within the context of the contract).

Each performance obligation is required to be accounted for separately.

Based on the above guidance, the following table discusses whether the common goods and services in property sale contract should be considered as separate performance obligation or not:

Goods/Service	Whether a separate Performance obligation (PO) or not	Reason
Common areas	Unlikely to be separate PO	Common areas are unlikely to be a separate performance obligation because the interests received in common areas are typically undivided interests that are not separable from the property itself. However, if the common areas were sold separately by the developer, then they could be considered as a separate performance obligation provided that it is distinct in the context of the contract.
Construction services and building material	Unlikely to be separate PO	Construction services and building materials can meet the first criterion as they are items that can be used in conjunction with other readily available goods or services. However, the developer would be considered to be providing a significant integration service as it is bringing together all the separate elements to deliver a complete building.

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Property management services and Golf membership	Likely to be separate PO	Property management services and golf membership are likely to be separate performance obligations as they may be used in isolation or with the property already acquired, i.e., management services can be used with the property. These types of services are not significantly customised, integrated with, or dependent on the property. This is because there is no change in their function with or without the property. Also, a property management service could be undertaken by a third party.
Car park and Land entitlement	Analysis required	Items such as car parks and land entitlements generally meet the first criterion – i.e., capable of being distinct – as the buyer benefits from them on their own. Whether the second criterion is met depends on the facts and circumstances. For example, if the land entitlement can be sold separately or pledged as security as a separate item, it may indicate that it is not highly dependent on, or integrated with, other rights received in the contract. In an apartment scenario, the customer can receive an undivided interest in the land on which the apartment block sits. This type of right is generally considered as highly inter-related with the apartment itself.*

* However, if title to the land is transferred to the buyer separately – for example in a single party development – then the separately identifiable criterion may be met.

PS: Other facts and circumstances of each contract should also be carefully examined to determine performance obligations.

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11. On initial measurement, Entity X will measure the lease liability and ROU asset as under:

Year	Lease Payments (USD)	Present Value factor @ 5%	Present Value of Lease Payment	Conversion rate (spot rate)	INR value
1	10,000	0.952	9,520	68	6,47,360
2	10,000	0.907	9,070	68	6,16,760
3	10,000	0.864	8,640	68	5,87,520
4	10,000	0.823	8,230	68	5,59,640
5	10,000	0.784	7,840	68	5,33,120
Total			**43,300**		**29,44,400**

As per Ind AS 21, The Effects of Changes in Foreign Exchange Rates, monetary assets and liabilities are restated at each reporting date at the closing rate and the difference due to foreign exchange movement is recognised in profit and loss whereas non-monetary assets and liabilities carried measured in terms of historical cost in foreign currency are not restated.

Accordingly, the ROU asset in the given case being a non-monetary asset measured in terms of historical cost in foreign currency will not be restated but the lease liability being a monetary liability will be restated at each reporting date with the resultant difference being taken to profit and loss.

At the end of Year 1, the lease liability will be measured in terms of USD as under:

Lease Liability:

Year	Initial Value (USD) (a)	Lease Payment (b)	Interest @ 5% (c) = (a x 5%)	Closing Value (USD) (d = a + c - b)
1	43,300	10,000	2,165	35,465

Interest at the rate of 5% will be accounted for in profit and loss at average rate of ₹ 69 (i.e., USD 2,165 x 69) = ₹ 1,49,385.

Particulars		Dr. (₹)	Cr. (₹)
Interest Expense	Dr.	1,49,385	
To Lease liability			1,49,385

Lease payment would be accounted for at the reporting date exchange rate, i.e. ₹ 70 at the end of year 1

Particulars		Dr. (₹)	Cr. (₹)
Lease liability	Dr.	7,00,000	
To Cash			7,00,000

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As per the guidance above under Ind AS 21, the lease liability will be restated using the reporting date exchange rate i.e., ₹ 70 at the end of Year 1. Accordingly, the lease liability will be measured at ₹ 24,82,550 (35,465 x ₹ 70) with the corresponding impact due to exchange rate movement of ₹ 88,765 (24,82,550 – (29,44,400 + 1,49,385 – 700,000) taken to profit and loss.

At the end of year 1, the ROU asset will be measured as under:

Year	Opening Balance (₹)	Depreciation (₹)	Closing Balance (₹)
1	29,44,400	5,88,880	23,55,520

12. Journal Entries

Books of Company P

Particulars	Debit (₹)	Credit (₹)
Investment in Company B Dr.	2,17,500	
To Equity Share Capital A/c (2,500 shares x ₹ 10)		25,000
To Securities Premium A/c (2,500 shares x ₹ 77)		1,92,500
(Being allotment of 25 shares each to 100 employees of B at fair value of ₹ 87 per share)		

Books of Company B

Particulars	Debit (₹)	Credit (₹)
Employee Benefit Expense A/c Dr.	2,17,500	
To Capital Contribution from Parent P		2,17,500
(Being issue of shares by Parent to Employees pursuant to Group Share-based Payment Plan)		

13. Computation of Goodwill / Capital reserve on consolidation as per Ind AS 103

Particulars	₹
Cost of investment:	
Share exchange (50,000 x 25)	12,50,000
Cash consideration	50,00,000
Contingent consideration	9,80,000
Consideration transferred at date of acquisition [A]	72,30,000
Fair value of non-controlling interest at date of acquisition [B] (1,00,000 x 35% x 12)	4,20,000
Total [C] = [A] + [B]	76,50,000

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Net assets acquired at date of acquisition [D]	(80,00,000)
Capital Reserve [D] – [C]	3,50,000

In a business combination, acquisition-related costs (including stamp duty) are expensed in the period in which such costs are incurred and are not included as part of the consideration transferred. Therefore, ₹ 1,50,000 incurred by Nafa Ltd. in relation to acquisition, will be ignored by Bima Ltd.

Journal entry at the date of acquisition by Bima Limited as per Ind AS 103:

		₹	₹
Identifiable net assets	Dr.	80,00,000	
To Equity share capital (50,000 x 10)			5,00,000
To Securities Premium (50,000 x 15)			7,50,000
To Cash			50,00,000
To Provision for contingent consideration to Nafa Ltd.			9,80,000
To Non-controlling Interest			4,20,000
To Capital Reserve			3,50,000

14.

Activity	**Whether in the scope of Ind AS 41?**	**Remarks**
Managing animal-related recreational activities like Zoo	No	Since the primary purpose is to show the animals to public for recreational purposes, there is no management of biological transformation but simply control of the number of animals. Hence it will not fall in the purview of considered in the definition of agricultural activity.
Fishing in the ocean	No	Fishing in ocean is harvesting biological assets from unmanaged sources. There is no management of biological transformation since fish grow naturally in the ocean. Hence, it will not fall in the scope of the definition of agricultural activity.
Fish farming	Yes	Managing the growth of fish and then harvest for sale is agricultural activity within the scope of Ind AS 41 since there is management of biological transformation of

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		biological assets for sale or additional biological assets.
Development of living organisms such as cells, bacteria viruses	Analysis required	The development of living organisms for research purposes does not qualify as agricultural activity, as those organisms are not being developed for sale, or for conversion into agricultural produce or into additional biological assets. Hence, development of such organisms for the said purposes does not fall under the scope of Ind AS 41. However, if the organisms are being developed for sale or use in dairy products, the activity will be considered as agricultural activity under the scope of Ind AS 41.
Growing of plants to be used in the production of drugs	Yes	If an entity grows plants for using it in production of drugs, the activity will be agricultural activity. Hence it will come under the scope of Ind AS 41.
Purchase of 25 dogs for security purposes of the company's premises	No	Ind AS 41 is applied to account for the biological assets when they relate to agricultural activity. Guard dogs for security purposes do not qualify as agricultural activity, since they are not being kept for sale, or for conversion into agricultural produce or into additional biological assets. Hence, they are outside the scope of Ind AS 41.

15. ***1 April 20X1***

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

Particulars	Year 1 (₹)	Year 2 (₹)	Year 3 (₹)	Total (₹)
Cash flows based on interest rate of 11% (A)	1,10,000	1,10,000	1,10,000	3,30,000
Cash flows based on interest rate of 8% (B)	80,000	80,000	80,000	2,40,000
Interest rate differential (A-B)	30,000	30,000	30,000	90,000

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Discount factor @ 11%	0.901	0.812	0.731	
Interest rate differential discounted at 11%	27,030	24,360	21,930	73,320
Fair value of financial guarantee contract (at inception)				**73,320**

Journal Entry

Particulars		Debit (₹)	Credit (₹)
Investment in subsidiary	Dr.	73,320	
To Financial guarantee (liability)			73,320
(Being financial guarantee initially recorded)			

31 March 20X2

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

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

At 31 March 20X2, there is 1% probability that Moon Limited may default on the loan in the next 12 months. If Moon Limited defaults on the loan, Sun Limited does not expect to recover any amount from Moon Limited. The 12-month expected credit losses are therefore ₹10,000 (₹10,00,000 x 1%).

The initial amount recognised less amortisation is ₹51,385 (₹73,320 + ₹8,065 (interest accrued based on EIR)) – ₹30,000 (benefit of the guarantee in year 1) Refer table below. The unwound amount is recognised as income in the books of Sun Limited, being the benefit derived by Moon Limited not defaulting on the loan during the period.

Year	Opening balance ₹	EIR @ 11%	Benefits provided ₹	Closing balance ₹
1	73,320	8,065	(30,000)	51,385
2	51,385	5,652	(30,000)	27,037
3	27,037	2,963*	(30,000)	-

* Difference is due to approximation

The carrying amount of the financial guarantee liability after amortisation is therefore ₹ 51,385, which is higher than the 12-month expected credit losses of ₹ 10,000. The liability is therefore adjusted to ₹ 51,385 (the higher of the two amounts) as follows:

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Particulars	Debit (₹)	Credit (₹)
Financial guarantee (liability) Dr.	21,935	
To Profit or loss		21,935
(Being financial guarantee subsequently adjusted)		

31 March 20X3

At 31 March 20X3, there is 3% probability that Moon Limited will default on the loan in the next 12 months. If Moon Limited defaults on the loan, Sun Limited does not expect to recover any amount from Moon Limited. The 12-month expected credit losses are therefore ₹ 30,000 (₹ 10,00,000 x 3%).

The initial amount recognised less accumulated amortisation is ₹ 27,037, which is lower than the 12-month expected credit losses (₹ 30,000). The liability is therefore adjusted to ₹ 30,000 (the higher of the two amounts) as follows:

Particulars	Debit (₹)	Credit (₹)
Financial guarantee (liability) Dr.	21,385*	
To Profit or loss (Note)		21,385
(Being financial guarantee subsequently adjusted)		

* The carrying amount at the end of 31 March 20X2 = ₹ 51,385 less 12-month expected credit losses of ₹ 30,000.

16. **(a)** As per paragraph 66(a) of Ind AS 1, an entity shall classify an asset as current when it expects to realise the asset, or intends to sell or consume it, in its normal operating cycle.

Paragraph 68 provides the guidance that current assets include assets (such as inventories and trade receivables) that are sold, consumed or realised as part of the normal operating cycle even when they are not expected to be realised within twelve months after the reporting period.

In accordance with above, the receivables that are considered a part of the normal operating cycle will be classified as current asset.

If the operating cycle exceeds twelve months, then additional disclosure as required by paragraph 61 of Ind AS 1 is required to be given in the notes.

(b) As discussed in point (a) above, advances to suppliers for goods and services would be classified in accordance with normal operating cycle if it is given in relation to the goods or services in which the entity normally deals. If the advances are considered a part the normal operating cycle, it would be classified as a current asset. If the operating cycle exceeds twelve months, then additional disclosure as required by paragraph 61 of Ind AS 1 is required to be given in the notes.

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(c) Classification of income tax receivables [other than deferred tax] will be driven by paragraph 66 (c) of Ind AS 1, i.e., based on the expectation of the entity to realise the asset. If the receivable is expected to be realised within twelve months after the reporting period, then it will be classified as current asset else non-current asset.

(d) Para 8 of Ind AS 16 states that items such as spare parts, stand-by equipment and servicing equipment are recognised in accordance with this Ind AS when they meet the definition of property, plant and equipment. Otherwise, such items are classified as inventory.

Accordingly, the insurance spares that are treated as an item of property, plant and equipment would normally be classified as non-current asset whereas insurance spares that are treated as inventory will be classified as current asset if the entity expects to consume it in its normal operating cycle.

17. 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.

In this case, the amount of goodwill will be as follows:

Net identifiable asset	Dr.	₹ 23 million	
Goodwill (bal. fig.)	Dr.	₹ 1.4 million	
To Bank (Purchase consideration)			₹ 17.5 million
To NCI (23 x 30%)			₹ 6.9 million

Thus, goodwill on reporting date in the books of Monsoon Limited would be

= 1.4 million EURO x ₹ 84 = ₹ 117.6 million.

18. Computation of Expected Return on Plan Assets

Particulars	₹
Return on ₹ 10,00,000 for 20X0-20X1 at 10.25% = ₹ 10,00,000 x 10.25%	1,02,500
Add: Return on ₹ 3,00,000 for 6 months at 10% Normal Rate = [3,00,000 (Inflow ₹ 4,90,000 less Payments ₹ 1,90,000) x 10% x 6/12)]	15,000
Expected Return on Plan Assets	**1,17,500**

Computation of Actual Return on Plan Assets

Particulars	₹
Fair Value of Plan Assets at the year-end – 31 March 20X1	15,00,000
Less: Fair Value of Plan Assets at the beginning – 1 April 20X0	(10,00,000)

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Less: Contributions received during the year 20X0-20X1	(4,90,000)
Add: Benefits paid during the year 20X0-20X1	1,90,000
Actual Return on Plan Assets	**2,00,000**

Computation of Net Actuarial Gain

Particulars	₹
Actual Return on Plan Assets	2,00,000
Less: Expected Return on Plan Assets	(1,17,500)
Actuarial Gain on Plan Assets	82,500
Less: Actuarial Loss on Defined Benefit Obligation (given)	(6,000)
Net Actuarial Gain to be recognized in 'Other Comprehensive Income'	**76,500**

19. As per Ind AS 36, the revised carrying amount of asset ASSOTA would be ₹6,50,000.

The tax base of asset ASSOTA is given as ₹8,00,000.

Carrying base of asset = ₹6,50,000

Tax base of asset = ₹8,00,000

Since tax base is greater than carrying base of asset, so deferred tax asset would be created on the temporary difference of ₹1,50,000 (₹8,00,000 – ₹6,50,000) at the given tax rate of 30%.

Hence, Deferred tax asset for the asset ASSOTA would be ₹1,50,000 x 30% = ₹45,000.

20. The goodwill on consolidation of Mission Ltd that is recognized in the consolidated balance sheet of Vision Ltd is ₹ 30 million (₹ 190 million – 80% x ₹ 200 million). This can only be reviewed for impairment as part of the cash generating units to which it relates. Since here the goodwill cannot be meaningfully allocated to the units, the impairment review is in two parts.

Units A and C have values in use that are more than their carrying values. However, the value in use of Unit B is less than its carrying amount. This means that the assets of unit B are impaired by ₹ 24 million (₹ 90 million – ₹ 66 million). This impairment loss will be charged to the statement of profit and loss.

Assets of Unit B will be written down on a pro-rata basis as shown in the table below:

(₹ in million)

Asset	**Impact on carrying value**		
	Existing	**Impairment**	**Revised**
Intangible assets	10	(4)	6
Property, plant and equipment	50	(20)	30

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Current assets	30	Nil*	30
Total	90	(24)	66

* The current assets are not impaired because they are expected to realize at least their carrying value when disposed of.

Following this review, the three units plus the goodwill are reviewed together i.e. treating Mission Limited as single cash generating Unit. The impact of this is shown in the following table, given that the recoverable amount of the business as a whole is ₹ 350 million: **(₹ in million)**

Component	Impact of impairment review on carrying value		
	Existing	Impairment	Revised
Goodwill (see note below)	37.50	(23.50)	14.00
Unit A	170.00	Nil	170.00
Unit B (revised)	66.00	Nil	66.00
Unit C	100.00	Nil	100.00
Total	373.50	(23.50)	350.00

Note: As per Appendix C of Ind AS 36, given that the subsidiary is 80% owned the goodwill must first be grossed up to reflect a notional 100% investment. Therefore, the goodwill will be grossed up to ₹ 37.50 million (₹ 30 million x 100/80).

The impairment loss of ₹ 23.50 million is all allocated to goodwill, leaving the carrying values of the individual units of the business as shown in the table immediately above.

The table shows that the notional goodwill that relates to a 100% interest is written down by ₹ 23.50 million to ₹ 14.00 million. However, in the consolidated financial statements the goodwill that is recognized is based on an 80% interest so the loss that is actually recognized is ₹ 18.80 million (₹ 23.50 million x 80%) and the closing consolidated goodwill figure is ₹ 11.20 million (₹ 14.00 million x 80%) or (₹ 30 million – ₹ 18.80 million).

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PAPER – 2: STRATEGIC FINANCIAL MANAGEMENT

QUESTIONS

Security Valuation

1. ABC Limited, just declared a dividend of ₹ 28.00 per share. Mr. A is planning to purchase the share of ABC Limited, anticipating increase in growth rate from 8% to 9%, which will continue for three years. He also expects the market price of this share to be ₹ 720.00 after three years.

   You are required to determine:

   (i) the maximum amount Mr. A should pay for shares, if he requires a rate of return of 13% per annum.

   (ii) the maximum price Mr. A will be willing to pay for share, if he is of the opinion that the 9% growth can be maintained indefinitely and require 13% rate of return per annum.

   (iii) the price of share at the end of three years, if 9% growth rate is achieved and assuming other conditions remaining same as in (ii) above.

   Note : Calculate rupee amount up to two decimal points and use PVF upto 3 decimal points.

2. KLM Limited has issued 90,000 equity shares of ₹ 10 each. KLM Limited's shares are currently selling at ₹ 72. The company has a plan to make a rights issue of one new equity share at a price of ₹ 48 for every four shares held.

   You are required to:

   (a) Calculate the theoretical post-rights price per share and analyse the change

   (b) Calculate the theoretical value of the right alone.

   (c) Suppose Mr. A who is holding 100 shares in KLM Ltd. is not interested in subscribing to the right issue, then advice what should he do.

Portfolio Management

3. Equity of ABC Ltd. (ABCL) is ₹ 500 Crores, its debt, is worth ₹ 290 Crores. Printer Division segments value is attributable to 64%, which has an Asset Beta (β_p) of 1.55, balance value is applied on Spares and Consumables Division, which has an Asset Beta (β_{sc}) of 1.40 ABCL Debt beta (β_D) is 0.28.

   You are required to calculate:

   (i) Equity Beta (β_E),

   (ii) Ascertain Equity Beta (β_E), if ABC Ltd. decides to change its Debt Equity position by raising further debt and buying back of equity to have its Debt to Equity Ratio at 1.50.

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Assume that the present Debt Beta (β_{D1}) is 0.45 and any further funds raised by way of Debt will have a Beta (β_{D2}) of 0.50.

(iii) Whether the new Equity Beta (β_E) justifies increase in the value of equity on account of leverage?

4. K Ltd. has invested in a portfolio of short-term equity investments. You are required to calculate the risk of K Ltd.'s short-term investment portfolio relative to that of the market from the information given below:

Investment	A	B	C	D
No. of shares	1,20,000	1,60,000	2,00,000	2,50,000
Market price per share (₹)	8.58	5.84	4.34	6.28
Beta	2.32	4.56	1.80	3.00
Expected Dividend Yield	9.50%	14.00%	7.50%	16.00%

The current market return is 20% and the risk free return is 10%.

Advise whether K Ltd. should change the composition of its portfolio. If yes, then how.

Note: Make calculations upto 4 decimal points.

Mutual Fund

5. The following particulars relating to S Fund Schemes:

Particulars			Value ₹ in Crores
1.	Investment in Shares (at cost)		
	a.	Pharmaceuticals companies	158
	b.	Construction Industries	62
	c.	Service Sector Companies	112
	d.	IT Companies	68
	e.	Real Estate Companies	20
2.	Investment in Bonds (Fixed Income)		
	a.	Listed Bonds (8000, 14% Bonds of ₹ 15,000 each)	24
	b.	Unlisted Bonds	14
3.	No. of Units outstanding (crores)		8.4
4.	Expenses Payable		7
5.	Cash and Cash equivalents		3
6.	Market expectations on listed bonds		8.842%

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The fund has incurred the following expenses:

Consultancy and Management fees ₹ 520 Lakhs

Office Expenses ₹ 180 Lakhs

Advertisement Expenses ₹ 48 Lakhs

Particulars relating to each sector are as follows:

Sector	Index on Purchase date	Index on Valuation date
Pharmaceutical companies	300	500
Construction Industries	275	490
Service Sector Companies	285	500
IT Companies	270	515
Real Estate Companies	265	440

Required:

(i) Calculate the Net Asset Value of the fund

(ii) Calculate the Net Asset Value per unit

(iii) Determine the Net return (Annualized), if the period of consideration is 4 years, and the fund has distributed ₹ 2 per unit per year as cash dividend during the same period.

Note: Calculate figure in ₹ Crore upto 3 decimal points.

Derivatives

6. The following data relate to R Ltd.'s share price:

Current price per share ₹ 1,900

6 months future's price/share ₹ 2050

Assuming it is possible to borrow money in the market for transactions in securities at 10% per annum,

(i) advise the justified theoretical price of a 6-months forward purchase; and

(ii) evaluate any arbitrage opportunity, if available.

7. The Following data relate to A Ltd.'s Portfolio:

Shares	X Ltd.	Y Ltd.	Z Ltd.
No. of Shares (lakh)	6	8	4
Price per share (₹)	1000	1500	500
Beta	1.50	1.30	1.70

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The CEO is of opinion that the portfolio is carrying a very high risk as compared to the market risk and hence interested to reduce the portfolio's systematic risk to 0.95. Treasury Manager has suggested two below mentioned alternative strategies:

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

(ii) Take appropriate position on Nifty Futures, currently trading at 8250 and each Nifty points multiplier is ₹ 210.

You are required to:

(a) Interpret the opinion of CEO, whether it is correct or not.

(b) Calculate the existing systematic risk of the portfolio,

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

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

(e) Advise the position to be taken in Nifty Futures and determine the number of Nifty contracts to be bought/sold; and

(f) Calculate the new systematic risk of portfolio if the company has taken position in Nifty Futures and there is 2% rise in Nifty.

Note: Make calculations in ₹ lakh and upto 2 decimal points.

Foreign Exchange Exposure and Risk Management

8. Doom Ltd. is an export business house. The company prepares invoice in customers' currency. Its debtors of US$ 48, 00,000 is due on April 1, 2020.

Market information as at January 1, 2020 is:

Exchange rates US$/INR		Currency Futures US$/INR	
Spot	0.014285	Contract size: ₹ 2,88,16,368	
1-month forward	0.014184	1-month	0.014178
3-months forward	0.013889	3-month	0.013881

	Initial Margin	Interest rates in India
1-Month	₹ 27,500	5.5%
3-Months	₹ 32,500	9%

On April 1, 2020 the spot rate US$/INR is 0.013894 and currency future rate is 0.013893.

Recommend as to which of the following methods would be most advantageous to Doom Ltd.

(i) Using forward contract

(ii) Using currency futures

(iii) Not hedging the currency risk

Note: Round off calculation upto zero decimal points.

9. Telereal Trillium, a UK Company is in the process of negotiating an order amounting €5.5 million with a large German retailer on 6 month's credit. If successful, this will be first time for Telereal Trillium has exported goods into the highly competitive German Market. The Telereal Trillium is considering following 3 alternatives for managing the transaction risk before the order is finalized.

(i) Mr. Grand, the Marketing head has suggested that in order to remove transaction risk completely Telereal Trillium should invoice the German firm in Sterling using the current €/£ average spot rate to calculate the invoice amount.

(ii) Mr. John, CE is doubtful about Mr. Grand's proposal and suggested an alternative of invoicing the German firm in € and using a forward exchange contract to hedge the transaction risk.

(iii) Ms. Royce, CFO is agreed with the proposal of Mr. John to invoice the German first in €, but she is of opinion that Telereal Trillium should use sufficient 6 month sterling future contracts (to the nearest whole number) to hedge the transaction risk.

Following data is available

Spot Rate	€ 1.1980 - €1.1990/£
6 months forward points	0.60 – 0.55 Euro Cents.
6 month future contract is currently trading at	€ 1.1943/£
6 month future contract size is	£70,500
After 6 month Spot rate and future rate	€ 1.1873/£

You are required to

(a) Advise the alternative you consider to be most appropriate.

(b) Interpret the proposal of Mr. Grand from non-financial point of view.

Note: Calculate (to the nearest £) the £ receipt.

International Financial Management

10. Right Limited has proposed to expand its operations for which it requires funds of $ 30 million, net of issue expenses which amount to 4% of the issue size. It proposed to raise the funds though a GDR issue. It considers the following factors in pricing the issue:

(i) The expected domestic market price of the share is ₹ 300 (Face Value of ₹ 10 each share)

(ii) 4 shares underly each GDR

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(iii) Underlying shares are priced at 20% discount to the market price

(iv) Expected exchange rate is ₹ 70/$

You are required to compute the number of GDR's to be issued and cost of GDR to Right Limited, if 20% dividend is expected to be paid with a growth rate of 20%.

Interest Rate Risk Management

11. Espaces plc is consumer electronics wholesaler. The business of the firm is highly seasonal in nature. In 6 months of a year, firm has a huge cash deposits and especially near Christmas time and other 6 months firm cash crunch, leading to borrowing of money to cover up its exposures for running the business.

    It is expected that firm shall borrow a sum of £25 million for the entire period of slack season in about 3 months.

    The banker of the firm has given the following quotations for Forward Rate Agreement (FRA):

Spot	5.50% - 5.75%
3 × 6 FRA	5.59% - 5.82%
3 × 9 FRA	5.64% - 5.94%

    3-month £50,000 future contract maturing in a period of 3 months is quoted at 94.15.

    You are required to:

    (a) Advise the position to be taken in Future Market by the firm to hedge its interest rate risk and demonstrate how 3 months Future contract shall be useful for the firm, if later interest rate turns out to be (i) 4.5% and (ii) 6.5%

    (b) Evaluate whether the interest cost to Espace plc shall be less had it adopted the route of FRA instead of Future Contract.

    Note:- Ignore the time value of money in settlement amount for future contract.

Corporate Valuation

12. Sun Ltd. recently made a profit of ₹ 200 crore and paid out ₹ 80 crore (slightly higher than the average paid in the industry to which it pertains). The average PE ratio of this industry is 9. The estimated beta of Sun Ltd. is 1.2. As per Balance Sheet of Sun Ltd., the shareholder's fund is ₹ 450 crore and number of shares is 10 crore. In case the company is liquidated, building would fetch ₹ 200 crore more than book value and stock would realize ₹ 50 crore less.

    The other data for the industry is as follows:

Projected Dividend Growth	4%
Risk Free Rate of Return	6%

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Market Rate of Return 11%

Calculate the valuation of Sun Ltd. using

(a) P/E Ratio

(b) Dividend Growth Model

(c) Book Value

(d) Net Realizable Value

Mergers, Acquisitions and Corporate Restructuring

13. ABC Ltd. is intending to acquire XYZ Ltd. by way of merger and the following information is available in respect of these companies:

	ABC Ltd.	XYZ Ltd.
Total Earnings (E) (in lakh)	₹ 1200	₹400
Number of outstanding shares (S) (in lakh)	400	200
Price earnings ratio (P/E)	8	7

(a) Determine the maximum exchange ratio acceptable to the shareholders of ABC Ltd., if the P/E ratio of the combined firm is expected to be 8?

(b) Determine the minimum exchange ratio acceptable to the shareholders XYZ Ltd., if the P/E ratio of the combined firm is expected to be 10?

Note: Make calculation in lakh multiples and compute ratio upto 4 decimal points.

Theoretical Questions

14. (a) Explain the traits that an organisation should have to make itself financially sustainable.

(b) Describe the salient features of Foreign Currency Convertible Bonds.

(c) Explain how an organization interested in making investment in foreign country can assess Country Risk and mitigate this risk.

15. (a) 'Venture Capital Financing is a unique way of financing Startup'. Discuss.

(b) Explain the Secondary Participants involved in the process of Securitization of Instruments.

(c) Explain how Cash flow-based approach of valuation is different from Income based approach and also explain briefly the steps involved in this approach.

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SUGGESTED ANSWERS

1. (i) Expected dividend for next 3 years.

Year 1 (D_1) ₹ 28.00 (1.09) = ₹ 30.52

Year 2 (D_2) ₹ 28.00 $(1.09)^2$ = ₹ 33.27

Year 3 (D_3) ₹ 28.00 $(1.09)^3$ = ₹ 36.26

Required rate of return = 13% (Ke)

Market price of share after 3 years = (P_3) = ₹ 720

The present value of share

$$P_0 = \frac{D_1}{(1+ke)} + \frac{D_2}{(1+ke)^2} + \frac{D_3}{(1+ke)^3} + \frac{P_3}{(1+ke)^3}$$

$$P_0 = \frac{30.52}{(1+0.13)} + \frac{33.27}{(1+0.13)^2} + \frac{36.26}{(1+0.13)^3} + \frac{720}{(1+0.13)^3}$$

P_0 = 30.52(0.885) + 33.27(0.783) +36.26(0.693) +720(0.693)

P_0 = 27.01 + 26.05 + 25.13 + 498.96

P_0 = ₹ 577.15

(ii) If growth rate 9% is achieved for indefinite period, then maximum price of share should Mr. A willing be to pay is

$$P_0 = \frac{D_1}{(ke-g)} = \frac{₹\ 30.52}{0.13\text{-}0.09} = \frac{₹ 30.52}{0.04} = ₹\ 763$$

(iii) Assuming that conditions mentioned above remain same, the price expected after 3 years will be:

$$P_3 = \frac{D_4}{k_e - g} = \frac{D_3(1.09)}{0.13-0.09} = \frac{36.26x1.09}{0.04} = \frac{39.52}{0.04} = ₹\ 988$$

2. (a) Calculation of theoretical Post-rights (ex-right) price per share

$$\text{Ex-right value} = \left[\frac{MN+SR}{N+R}\right]$$

Where,

M = Market price,

N = Number of old shares for a right share

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S = Subscription price

R = Right share offer

$$= \left[\frac{₹72 \times 4 + ₹48 \times 1}{4+1}\right] = ₹\ 67.20$$

Thus, post right issue the price of share has reduced by ₹4.80 per share.

(b) Calculation of theoretical value of the rights alone:

= Ex-right price – Cost of rights share

= ₹ 67.20 – ₹ 48 = ₹ 19.20

Or

$$= \frac{₹\ 67.20 - ₹48}{4} = ₹\ 4.80$$

(c) If Mr. A is not interested in subscribing to the right issue, he can renounce his right eligibility @ ₹ 19.20 per right and can earn a gain of ₹ 480.

3. (i) Equity Beta

To calculate Equity Beta first we shall calculate Weighted Average of Asset Beta as follows:

= 1.55 x 0.64 + 1.40 x 0.36

= 0.992 + 0.504 = 1.496

Now we shall compute Equity Beta using the following formula:

$$\beta_{Asset} = \beta_{Equity}\left[\frac{E}{E + D(1 - t)}\right] + \beta_{Debt}\left[\frac{D\ (1 - t)}{E + D(1 - t)}\right]$$

Accordingly,

$$1.496 = \beta_{Equity}\left[\frac{500}{500 + 290}\right] + \beta_{Debt}\left[\frac{290}{500+290}\right]$$

$$1.496 = \beta_{Equity}\left[\frac{500}{790}\right] + 0.28\left[\frac{290}{790}\right]$$

β_{Equity} = 2.20

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(ii) Equity Beta on change in Capital Structure

Amount of Debt to be raised:

Particulars	Value (in ₹ Crore)
Total Value of Firm (Equity ₹ 500 crore + Debt ₹ 290 crore)	790
Desired Debt Equity Ratio	1.50 : 1.00
Desired Debt Level = $\frac{Total\ Value\ x\ Debt\ Ratio}{Debt\ Ratio + Equity\ Ratio}$	474
Less: Value of Existing Debt	(290)
Value of Debt to be Raised	184

Equity after Repurchase = Total value of Firm – Desired Debt Value

= ₹ 790 Crore – ₹ 474 Crore

= ₹ 316 Crore

Weighted Average Beta of ABCL:

Source of Finance	Investment (in ₹ Crore)	Weight	Beta of the Division	Weighted Beta
Equity	316	0.4	$\beta_{(E = X)}$	0.4x
Debt – 1	290	0.367	0.45	0.165
Debt – 2	184	0.233	0.50	0.117
	790	**Weighted Average Beta**		**0.282 + (0.4x)**

β_{ABCL} = 0.282 + 0.4x

1.496 = 0.282 + 0.4x

0.4x = 1.496 – 0.282

X = 1.214/0.4 = 3.035

$\beta_{New\ Equity}$ = 3.035

(iii) Yes, it justifies the increase as it leads to increase in the Value of Equity due to increase in Beta.

4. (i) To determine whether K Ltd. should change composition of its portfolio first we should determine the Beta of the Portfolio and compare it with implicit Beta as justified by the Return on Portfolio.

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Calculation of Beta of Portfolio

Investment	No. of shares	Market Price (₹)	Market Value	Dividend Yield	Dividend	Composition	β	Weighted β
A	1,20,000	8.58	10,29,600	9.50%	97,812	0.2339	2.32	0.5426
B	1,60,000	5.84	9,34,400	14.00%	1,30,816	0.2123	4.56	0.9681
C	2,00,000	4.34	8,68,000	7.50%	65,100	0.1972	1.80	0.3550
D	2,50,000	6.28	15,70,000	16.00%	2,51,200	0.3566	3.00	1.0698
			44,02,000		5,44,928	1.0000		2.9355

Return of the Portfolio $\frac{5,44,928}{44,02,000}$ =0.1238

Beta of Port Folio 2.9355

Market Risk implicit

0.1238 = 0.10 + β× (0.20 – 0.10)

Or, 0.10 β + 0.10 = 0.1238

$$\beta = \frac{0.1238 - 0.10}{0.10} = 0.238$$

Market β implicit is 0.238 while the portfolio β is 2.93. Thus, the portfolio is marginally risky compared to the market.

(ii) To decide whether K Ltd. should change the composition of its portfolio the dividend yield (given) should be compared with the Expected Return as per CAPM as follows:

Expected return as per CAPM is $R_f + (R_M - R_f)\ \beta$

Accordingly,

Expected Return for investment A	=	0.10 + (0.20 - 0.10) 2.32
	=	33.20%
Expected Return for investment B	=	0.10 + (0.20 - 0.10) 4.56
	=	55.60%
Expected Return for investment C	=	0.10 + (0.20 - 0.10) 1.80
	=	28%
For investment D, Rs	=	0.10 + (0.20 - 0.10) 3
	=	40%

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Comparing dividend yields with the expected returns of investment as per CAPM it can be observed that all investments are over-priced and they should be sold by the K Ltd. and acquire new securities.

5. (i) Calculation of NAV of the Fund

			(in ₹ Crore)
1.	Value of Shares		
	a. Pharmaceutical Companies	$158 \times \frac{500}{300}$	263.333
	b. Construction Companies	$62 \times \frac{490}{275}$	110.473
	c. Service Sector Companies	$112 \times \frac{500}{285}$	196.491
	d. IT Companies	$68 \times \frac{515}{270}$	129.704
	e. Real Estate Companies	$20 \times \frac{440}{265}$	33.208
2.	Investment in Bonds		
	a. Listed Bonds	$\frac{14}{8.842} \times 24$	38.00
	b. Unlisted Bonds		14.000
3.	Cash and Cash Equivalents		3.00
			788.209
	Less: Expense Payable		7.000
	NAV of the Fund		781.209

(ii) NAV of the Fund per Unit

NAV of the Fund	₹ 781.209 crore
Number of Units	8.40 crore
NAV Per Unit (₹ 781.209 crore/ 8.40 crore)	₹ 93.00

(iii) Net Return

Initial Cost Per Unit		
Investment in Shares	₹ 420 crore	

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Bonds	₹ 38 crore	₹ 458 crore
Number of Units		8.40 crore
Cost Per Unit		₹ 54.52
Return		
Capital Gain	(₹ 93.00 – ₹ 54.52)	₹ 38.48
Dividend	₹ 4x 2	₹ 8.00
		₹ 46.48
Annualised Return	$\frac{46.48}{54.52} \times \frac{1}{4}$	21.31%

6. **(i)** The justified theoretical price of a 6 months forward contract as per cost to carry model is as follows:

Theoretical minimum price = ₹ 1,900 + (₹ 1,900 x 10/100 x 6/12) = ₹ 1,995

(ii) Arbitrage Opportunity - Since current future price is ₹2050, yes there is an opportunity for carrying arbitrage profit. The arbitrageur can borrow money @ 10 % for 6 months and buy the shares at ₹ 1,900. At the same time he can sell the shares in the futures market at ₹ 2,050. On the expiry date 6 months later, he could deliver the share and collect ₹ 2,050 pay off ₹ 1,995 and record a risk –less profit of ₹ 55 (₹ 2,050 – ₹ 1,995).

7. **(a)** Yes, the apprehension of CEO is correct as the current portfolio is more riskier than market as the beta (Systematic Risk) of market portfolio is as computed as follows:

Shares	No. of shares (lakhs) (1)	Market Price of Per Share (2) (₹)	(1) × (2) (₹ lakhs)	% to total (w)	ß (x)	Wx
X Ltd.	6.00	1000.00	6000.00	0.30	1.50	0.45
Y Ltd.	8.00	1500.00	12000.00	0.60	1.30	0.78
Z Ltd.	4.00	500.00	2000.00	0.10	1.70	0.17
			20000.00	1.00		1.40

(b) Since the Beta of existing portfolio is 1.40, the systematic risk of the current portfolio is 1.40.

(c) Required Beta 0.95

Let the proportion of risk-free securities for target beta 0.95 = p

$$0.95 = 0 \times p + 1.40\ (1 - p)$$

$$p = 0.32 \text{ i.e. } 32\%$$

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Shares to be disposed off to reduce beta (20000 × 32%) ₹ 6,400 lakh and Risk Free securities to be acquired for the same amount.

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

Shares	% to total (w)	Proportionate Amount (₹ lakhs)	Market Price Per Share (₹)	No. of Shares (Lakh)
X Ltd.	0.30	1920.00	1000.00	1.92
Y Ltd.	0.60	3840.00	1500.00	2.56
Z Ltd.	0.10	640.00	500.00	1.28

(e) Since, the company is in long position in cash market it shall take short position in Future Market.

Number of Nifty Contract to be sold

$$\frac{(1.40\text{-}0.95) \times 20000 \text{ lakh}}{8{,}250 \times 210} = 519 \text{ contracts}$$

(f) If there is 2% rises in Nifty there will be 2.80%(2%x1.40) rise for portfolio of shares

	₹ Lakh
Current Value of Portfolio of Shares	20000
Value of Portfolio after rise	20560
Mark-to-Market Margin paid (8250 × 0.020 × ₹ 210 × 519)	179.83
Value of the portfolio after rise of Nifty	20380.17
% change in value of portfolio (20380.17 – 20000)/ 20000	1.90%
% rise in the value of Nifty	2%
New Systematic Risk (Beta)	0.95

8. Receipts using a forward contract = $ 48,00,000/0.013889 = ₹ 34,55,97,235

Receipts using currency futures

The number of contracts needed is ($ 48,00, 000/0.013881)/ 28,816,368	=	12
Initial margin payable is 12 contracts x ₹ 32,500	=	₹ 3,90,000
On April 1, 2020 Close at 0.013893		
Receipts = US$ 48,00,000/0.013894	=	₹ 34,54,72,866

Variation Margin

[(0.013893 – 0.013881) x 12 x 28,816,368]/0.013894

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OR (0.000012 x 12 x 28,816,368)/0.013894 = = 4149.5570/0.013894	₹ 2,98,658
Less: Interest Cost – ₹ 3,90,000 x 0.09 x 3/12	₹ 8,775
Net Receipts	₹ 34,57,62,749

Receipts under different methods of hedging

Forward contract	₹ 34,55,97,235
Future Contract	₹ 34,57,62,749
No Hedge (US$ 48,00,000/ 0.013894)	₹ 34,54,72,866

The most advantageous option would have been to hedge with futures as it is slightly higher than Forward Option but comparing to no hedge option it is better proposition.

9. (a) (i) Receipt under three proposals

(a) Proposal of Mr. Grand

Invoicing in £ will produce = $\frac{€5.5 \text{ million}}{1.1990}$ = £ 45, 87,156

(b) Proposal of Mr. John

Forward Rate= €1.1990 - 0.0055 = 1.1935

Using Forward Market hedge Sterling receipt would be $\frac{€5.5 \text{ million}}{1.1935}$ = £ 46,08,295

(c) Proposal of Ms. Royce

The equivalent sterling of the order placed based on future price (€1.1943)

= $\frac{€5.5 \text{ million}}{1.1943}$ = £ 46, 05,208 (rounded off)

Number of Contracts = $\frac{£46,05,208}{70,500}$ = 65 Contracts (to the nearest whole number)

Thus, € amount hedged by future contract will be = 65 $\times$ £70,500 = £45,82,500

Buy Future at	€1.1943
Sell Future at	€1.1873
	€0.0070

Total loss on Future Contracts = $65 \times £70,500 \times €0.0070$ = €32,078

After 6 months

Amount Received	€55, 00,000
Less: Loss on Future Contracts	€ 32,078
	€ 54, 67,922

Sterling Receipts

On sale of € at spot = $\frac{€54,67,922}{1.1873}$ = £46, 05,342

Proposal of option (ii) is preferable because the option (i) & (iii) produces least receipts.

(b) Further, in case of proposal (i) there must be a doubt as to whether this would be acceptable to German firm as it is described as a competitive market and Telereal Trillium is moving into it first time.

10. Net Issue Size = $30 million

Gross Issue = $\frac{\$30 \text{ million}}{0.96}$ = $31.25 million

Issue Price per GDR in ₹ (300 x 4 x 80%)	₹ 960
Issue Price per GDR in $ (₹ 960/ ₹ 70)	$13.71
Dividend per GDR (D_1) (₹ 2 x 4)	₹ 8
Net Proceeds per GDR (₹ 960 x 0.96)	₹ 921.60

(a) Number of GDR to be issued

$$\frac{\$31.25 \text{ million}}{\$13.71} = 2.2794 \text{ million}$$

(b) Cost of GDR to Right Ltd.

$$k_e = \frac{8}{921.60} + 0.20 = 20.87\%$$

11. (a) (i) Since firm is a borrower it will like to off-set interest cost by profit on Future Contract. Accordingly, if interest rate rises it will gain hence it should sell interest rate futures.

$$\text{No. of Contracts} = \frac{\text{Amount of Borrowing}}{\text{Contract Size}} \times \frac{\text{Duration of Loan}}{3 \text{ months}}$$

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$$= \frac{£\ 25,000,000}{£\ 50,000} \times \frac{6}{3} = 1000 \text{ Contracts}$$

(ii) The final outcome in the given two scenarios shall be as follows:

	If the interest rate turns out to be 4.5%	**If the interest rate turns out to be 6.5%**
Future Course Action :		
Sell to open	94.15	94.15
Buy to close	95.50 (100 - 4.5)	93.50 (100 - 6.5)
Loss/ (Gain)	1.35%	(0.65%)
Cash Payment (Receipt) for Future Settlement	£ 50,000×1000× 1.35%×3/12 = £1,68,750	£ 50,000×1000×0.65%×3/12 = (£81,250)
Interest for 6 months on £50 million at actual rates	£ 25 million × 4.5% × ½ = £ 5,62,500	£ 25 million × 6.5% × ½ = £ 8,12,500
	£ 7,31,250	£ 7,31,250

Thus, the firm locked itself in interest rate $\frac{£\ 7,31,250}{£\ 25,000,000} \times 100 \times \frac{12}{6} = 5.85\%$

(b) No, the interest cost shall not be less for Espace plc had it taken the route of FRA, as the 3 x 9 FRA contract are available at 5.64% – 5.94% i.e. borrowing rate of 5.94%. Hence, the interest cost under this option shall be nearby by 5.94% which is more than interest rate under Future contract rate of 5.85%.

12. (a) ₹ 200 crore x 9 = ₹ 1800 crore

(b) K_e = 6% + 1.2 (11% - 6%) = 12%

$$= \frac{80 \text{ crore} \times 1.04}{0.12 - 0.04} = ₹\ 1040 \text{ crore}$$

(c) ₹ 450 crore

(d) ₹ 450 crore + ₹ 200 crore – ₹ 50 crore = ₹ 600 crore

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13. (a) Maximum exchange ratio acceptable to the shareholders of ABC Ltd.

Market Price of share of ABC Ltd. (₹ 3 x 8)	₹ 24
No. of Equity Shares	400 lakh
Market Capitalisation of ABC Ltd. (₹ 24 x 400 lakh)	₹ 9600 lakh
Combined Earnings (₹ 1200 + ₹ 400) lakh	₹ 1600 lakh
Combined Market Capitalisation (₹ 1600 lakh x 8)	₹ 12800 lakh
Market Capitalisation of ABC Ltd. (₹ 24x 400 lakh)	₹ 9600 lakh
Balance for XYZ Ltd.	₹ 3200 lakh

Let D be the no. of equity shares to be issued to XYZ Ltd. then,

$$\frac{₹\,3200\,\text{Lakh}}{\left(\frac{1600\text{ Lakh}}{D+400}\right)\times 8} = D$$

D = 133.333 lakh Shares

Exchange Ratio = 133.333 / 200 = 0.6666:1

(b) Minimum exchange ratio acceptable to the shareholders of XYZ Ltd.

Market Price of share of XYZ Ltd.	₹ 14.00
No. of Equity Shares	200 lakh
Market Capitalisation of XYZ Ltd. (₹ 14.00 x 200 lakh)	₹ 2800 lakh
Combined Earnings (₹ 1200 + ₹ 400) lakh	₹ 1600 lakh
Combined Market Capitalisation (₹ 1600 lakh x 10)	₹ 16000 lakh
Balance for ABC Ltd.	₹ 13200 lakh

Let D be the no. of equity shares to be issued to XYZ Ltd. then,

$$\frac{₹\;2800\,\text{lakh}}{\left(\frac{1600\text{ lakh}}{D+400}\right)\times 10} = D$$

D = 84.8485 lakh Shares

Exchange Ratio = 84.8485 / 200 = 0.4242:1

14. (a) To be financially sustainable, an organization must have following traits:

- have more than one source of income.
- have more than one way of generating income.

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- do strategic, action and financial planning regularly.
- have adequate financial systems.
- have a good public image.
- be clear about its values (value clarity); and
- have financial autonomy.

(b) The salient features of FCCBs are as follows:

1. FCCB is a bond denominated in a foreign currency issued by an Indian company which can be converted into shares of the Indian Company denominated in Indian Rupees.
2. Prior permission of the Department of Economic Affairs, Government of India, Ministry of Finance is required for their issue
3. There will be a domestic and a foreign custodian bank involved in the issue
4. FCCB shall be issued subject to all applicable Laws relating to issue of capital by a company.
5. Tax on FCCB shall be as per provisions of Indian Taxation Laws and Tax will be deducted at source.
6. Conversion of bond to FCCB will not give rise to any capital gains tax in India.

(c) Organisation can assess country risk

(1) By referring political ranking published by different business magazines.

(2) By evaluating country's macro-economic conditions.

(3) By analyzing the popularity of current government and assess their stability.

(4) By taking advises from the embassies of the home country in the host countries.

Further, following techniques can be used to mitigate this risk.

(i) Local sourcing of raw materials and labour.

(ii) Entering into joint ventures

(iii) Local financing

(iv) Prior negotiations

15. (a) Yes, Venture Capital Financing is unique manner of financing a Startup as it possesses the following characteristics:

(i) **Long time horizon**: The fund would invest with a long time horizon in mind. Minimum period of investment would be 3 years and maximum period can be 10 years.

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(ii) **Lack of liquidity**: When VC invests, it takes into account the liquidity factor. It assumes that there would be less liquidity on the equity it gets and accordingly it would be investing in that format. They adjust this liquidity premium against the price and required return.

(iii) **High Risk**: VC would not hesitate to take risk. It works on principle of high risk and high return. So, high risk would not eliminate the investment choice for a venture capital.

(iv) **Equity Participation**: Most of the time, VC would be investing in the form of equity of a company. This would help the VC participate in the management and help the company grow. Besides, a lot of board decisions can be supervised by the VC if they participate in the equity of a company.

(b) Secondary participants involved into the securitization process are as follows:

(i) Obligors: Actually they are the main source of the whole securitization process. They are the parties who owe money to the firm and are assets in the Balance Sheet of Originator. The amount due from the obligor is transferred to SPV and hence they form the basis of securitization process and their credit standing is of paramount importance in the whole process.

(ii) Rating Agency: Since the securitization is based on the pools of assets rather than the originators, the assets have to be assessed in terms of its credit quality and credit support available. Rating agency assesses the following:

- ❖ Strength of the Cash Flow.
- ❖ Mechanism to ensure timely payment of interest and principle repayment.
- ❖ Credit quality of securities.
- ❖ Liquidity support.
- ❖ Strength of legal framework.

Although rating agency is secondary to the process of securitization but it plays a vital role.

(iii) Receiving and Paying agent (RPA): Also, called Servicer or Administrator, it collects the payment due from obligor(s) and passes it to SPV. It also follow up with defaulting borrower and if required initiate appropriate legal action against them. Generally, an originator or its affiliates acts as servicer.

(iv) Agent or Trustee: Trustees are appointed to oversee that all parties to the deal perform in the true spirit of terms of agreement. Normally, it takes care of interest of investors who acquires the securities.

(v) Credit Enhancer: Since investors in securitized instruments are directly exposed to performance of the underlying and sometime may have limited or no recourse to the

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originator, they seek additional comfort in the form of credit enhancement. In other words, they require credit rating of issued securities which also empowers marketability of the securities.

Originator itself or a third party say a bank may provide this additional context called Credit Enhancer. While originator provides his comfort in the form of over collateralization or cash collateral, the third party provides it in form of letter of credit or surety bonds.

(vi) **Structurer:** It brings together the originator, investors, credit enhancers and other parties to the deal of securitization. Normally, these are investment bankers also called arranger of the deal. It ensures that deal meets all legal, regulatory, accounting and tax laws requirements.

(c) As opposed to the asset based and income based approaches, the cash flow approach takes into account the quantum of free cash that is available in future periods, and discounting the same appropriately to match to the flow's risk.

Simply speaking, if the present value arrived post application of the discount rate is more than the current cost of investment, the valuation of the enterprise is attractive to both stakeholders as well as externally interested parties (like stock analysts). It attempts to overcome the problem of over-reliance on historical data.

There are essentially five steps in performing DCF based valuation:

(i) Arriving at the 'Free Cash Flows'

(ii) Forecasting of future cash flows (also called projected future cash flows)

(iii) Determining the discount rate based on the cost of capital

(iv) Finding out the Terminal Value (TV) of the enterprise

(v) Finding out the present values of both the free cash flows and the TV, and interpretation of the results.

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PAPER – 3 : ADVANCED AUDITING AND PROFESSIONAL ETHICS

PART – I ACADEMIC UPDATE

(Legislative Amendments / Notifications / Circulars / Rules / Guidelines issued by Regulating Authority)

Students are required to refer updated Chapters applicable for May 2021 Examination on the below mentioned link:

Chapter. No.	Chapter Name	Link
Chapter 5	The Company Audit	**https://resource.cdn.icai.org/63102bos51055-cp5.pdf**
Chapter 11	Audit of Non-Banking Financial Companies	https://resource.cdn.icai.org/63103bos51055-cp11.pdf
Chapter 13	Audit of Public Sector Undertakings	https://resource.cdn.icai.org/63104bos51055-cp13.pdf
Chapter 14	Liabilities of Auditors	https://resource.cdn.icai.org/63105bos51055-cp14.pdf

Note: Students are also advised to refer RTP of Paper 1 Financial Reporting (for AS, Ind AS and other updates) and Paper 4 Part I -Corporate Laws (for academic updates relating to Company Law).

PART – II : QUESTIONS AND ANSWERS

QUESTIONS

PART A: MULTIPLE CHOICE QUESTIONS

Integrated Case Scenario 1.

M/s. Suresh & Co., a partnership firm, has been appointed, for the 7th consecutive year, as the statutory auditor of Alkis Ltd., an unlisted public company, for financial year 2020-21.

Mr. Suresh is the engagement partner for the audit assignment of Alkis Ltd. The engagement team, before starting the assignment, was made to read the policies and procedures designed to achieve desired quality control, with respect to the type of assignment being undertaken.

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Mr. Suresh, referred the engagement letter, signed with the management initially and was considering whether there was a requirement to send a new engagement letter, in light of following circumstances in the Company during F.Y. 2020-21:

- Two senior whole time directors of the Company have retired out of total five directors.
- 40% stake in the Company was held by promoters, which was reduced to 5%, by selling shares to general public.
- One more factory unit was set up in Gorakhpur, this year.
- Management has requested to cover 90% of the transactions with respect to each revenue line item, this time, instead of 80% of the transactions, as was set out in the audit plan, considering the materiality and other factors.

The following data is presented from the audited financial statements of Alkis Ltd., for the financial year 2019-2020:

(I) Paid up share capital - ₹ 8 crore;

(II) Turnover - ₹ 55 crore;

(III) Outstanding Borrowings - ₹ 14 crore;

(IV) Outstanding Public Deposits - ₹ 28 crore.

Mr. Suresh while preparing a report under section 143 of the Companies Act, 2013, made a statement with respect to the remuneration paid by the Alkis Ltd. to one of its directors, Mr. Mahesh, was in excess of the limit laid down under section 197 and also gave such other details as prescribed.

Mr. Suresh, for additional reporting purpose, while auditing with respect to compliance with CARO, 2016, observed the following, relevant to Para 3(vii) of CARO, 2016:

Statutory Dues	Undisputed Amount (₹ in lakh)	Date Payable	Date Paid
Income Tax Demand for A.Y. 2018-19	2	25th September, 2020	28th March, 2021
GST	1.5	3rd October, 2020	4th April, 2021
Customs Duty	0.80	20th September, 2020	10th April, 2021
Provident Fund	0.45	12th October, 2020	Not Paid till date

Also, a representation was made to GST Department for waiving a penalty of ₹ 1 lakh for late payment of GST demand.

The board of Alkis Ltd. declared interim dividend of ₹ 20 lakh on 20th May, 2021, to its 180 shareholders, out of surplus in the profit and loss account and such dividend amount was deposited in a separate bank with a branch of SBI.

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Dividend amounting to ₹ 1 lakh was not claimed by a shareholder, Mr. Rohit, till 19th June, 2021, and so the said amount of ₹ 1 lakh was transferred to Unpaid Dividend Account on 31st July, 2020.

On the basis of the abovementioned facts, you are required to answer the following MCQs:

Question No.: (1-5)

1. Which of the following option is correct with respect to Alkis Ltd.?
   - (a) Alkis Ltd. needs to form an Audit Committee. Further, provisions relating to internal audit as well as rotation of auditors are applicable to Alkis Ltd.
   - (b) Alkis Ltd. need not to form an Audit Committee. Further, provisions relating to internal audit is not applicable to Alkis Ltd. However, the provisions with respect to rotation of auditors are applicable to it.
   - (c) Alkis Ltd. need not to form an Audit Committee. Further, provisions relating to rotation of auditors is not applicable to Alkis Ltd. However, the provisions with respect to internal audit are applicable to it.
   - (d) Alkis Ltd. needs to form an Audit Committee. Provisions relating to internal audit is applicable to Alkis Ltd. However, the provisions with respect to rotation of auditors are not applicable to it.
2. Under which section of the auditor's report, Mr. Suresh needs to report with respect to the excess remuneration being paid to Mr. Mahesh?
   - (a) Other Matters Paragraph.
   - (b) Report on Other Legal and Regulatory Requirements.
   - (c) Basis for Qualified Opinion.
   - (d) Auditor's Responsibilities for the Audit of the Financial Statements.
3. What total amount of statutory dues needs to be reported by Mr. Suresh as per Para 3 of CARO?
   - (a) ₹ 2.75 lakh.
   - (b) ₹ 0.80 lakh.
   - (c) ₹ 2.80 lakh.
   - (d) ₹ 2.30 lakh.
4. How much amount of interest Alkis Ltd. would be liable to pay with respect to unpaid dividend amount?
   - (a) ₹ 575.
   - (b) ₹ 1,216.
   - (c) ₹ 1,726.

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(d) ₹ 1,151.

5. By what date, the amount of interim dividend should have been deposited in the scheduled bank after being declared and also by what date, the unpaid or unclaimed dividend amount should have been transferred to Unpaid Dividend Account?

   (a) 25th May, 2021 and 24th June, 2021, respectively.

   (b) 25th May, 2021 and 26th June, 2021, respectively.

   (c) 30th May, 2021 and 19th July, 2021, respectively.

   (d) 27th May, 2021 and 26th June, 2021, respectively.

Integrated Case Scenario 2.

Victor & Co; a reputed Chartered Accountants firm is appointed as a Statutory auditor of Copper Man Creations Limited. The Company is into manufacturing of robotic products. The Company has advanced in all its endeavours by supplying million Copper suits. The Company has started the production of version 10 under its flagship and tags it as "Why to worry about a vehicle, when you have steel man". The main idea of the Company evolved after the promoter watched the Marvel series Iron Man. The product has been promoted by Robert Downy Jr as its product Brand Ambassador. The Company expects itself to manufacture these prototypes and expects the old prototypes to be obsolete due to the demand for version 10. Each version of the product has a separate department and promotes their sales under the single flagship of 'Copper Man' and thus, the managerial decision making is left to each version manager. You have assigned the 'Fixed Assets area' to Mr. Mamma Mia and he came out to you with the following points.

You need to answer the questions raised by him and go through the notes prepared to reach a reasonable conclusion over Property, Plant and Equipment FSLI (Financial Statement caption):

- The Company is holding the property in its name in Andaman & Nicobar while the land is registered in another person's name. The property is in dispute for the past 20 years. This is the major plant for the Company and it is the critical success factor for the client. The Company's 80% of the revenue is derived from this factory. When enquired with management, it would have to incur huge costs to relocate and the present advantageous conditions of the plant are very critical for the product manufactured. The Company has not conducted the physical verification of fixed assets since last 10 years but it has conducted the verification at other locations every year. When enquired with management, the Company explained it is highly impossible as the plant is 24*7 running and it couldn't be halted as the restart of operations will cost huge amounts and a month's time to get the Company back to current position.

- The audit team has come across a transaction where the Company is enjoying the property rent free. The audit team is of the opinion that the provisions of Benami transactions (Prohibition) Act, 1988 might apply in such scenario. This should be evaluated as part of CARO reporting. No other procedures in this regard need to be performed.

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- The Company follows the depreciation policy as per the Schedule II across all the factories even when the factory at Andaman & Nicobar is the only factory that runs 24*7. The useful life has been taken as it is mentioned in the Schedule II without modifications and the Company's future prospects are good, there are no impairment indications.

  On the basis of the abovementioned facts, you are required to choose the most appropriate answer for the following MCQs:

Question No.: (6-10)

6. The audit team has asked you about the Benami Transaction:

   (a) There is no requirement for the auditor to report the transaction as there are no proceedings initiated or pending against the Company under the Benami Transactions (Prohibition) Act, 1988.

   (b) As the auditor is not sure about the transaction and did not gather proper evidence, he can ignore the transaction. The auditor needs to obtain the representation letter and note the same as a follow up point for the next year audit.

   (c) The auditor needs to obtain the additional evidence about the transaction. He needs to assess the situation as to its impact over the financial statements along-with consideration of SA 250. Thus, he should consider the seriousness of matter and should assess the impact of the same over the report even though it is not required to be reported as part of CARO.

   (d) The auditor needs to report such matter as a part of CARO as it might turn into a potential issue under the Benami Transactions (Prohibition) Act, 1988.

7. The audit team has asked you about the implications of dispute on the Property, Plant and Equipment and whether any additional considerations/reporting are needed for the same:

   (a) The dispute on account of Property, Plant and Equipment is a civil case and one or the other Company may face such consequences. Thus, no additional audit procedures are required. However, auditor may report this fact under CARO.

   (b) The Property, Plant and Equipment is in dispute and the Company has to incur huge costs to identify the ideal plant with same conditions. Thus, this might amount to material uncertainty on the Company's side to continue as a going concern. Thus, he needs to report the same. However, he need not to report under CARO.

   (c) The Property, Plant and Equipment is under dispute, the auditor needs to report it as a key audit matter and request the Company to disclose it in notes to accounts in a single line that the property is in dispute. However, he need not to report under CARO.

   (d) The Company's major line of business is from the factory, which is under dispute, the audit team need to consider the status of the case and assess its implications over the going concern assumption of the Company if it loses its case. It should also report it as part of Sec 143(3) about the Company's financial transactions or matters which

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have an adverse impact on the functioning of the Company. It also needs to be reported as per CARO.

8. The audit team has asked you about the impairment of assets of the Company.

   (a) The Company has no impairment condition as the Company expects positive future cash flows from the assets and thus no need to assess the impairment.

   (b) The Company need to assess the impairment condition for the assets and need to assess the fair value of the assets used to generate income from the older versions. The auditee needs to take a decision based on the cash inflows of a Company as a whole for assessing the existence of the impairment condition.

   (c) There exists an impairment condition as the Company does not expect much business from the older versions due to anticipation of the huge demand of the new product. The Company need to assess the cash inflows at each version level.

   (d) The Company need not assess impairment of assets as this is very common in dynamic industries where the older versions become obsolete when the new one is introduced by the Company.

9. The audit team is sceptical about the Depreciation policy followed by the Company for the Andaman and Nicobar plant:

   (a) As the Company is following the Schedule II, the depreciation policy and the useful life is in line with the Companies Act, 2013. Hence the Company's depreciation policy is good to go.

   (b) As the Company is operating the plant 24*7, it will be eligible for extra shift depreciation as per Schedule II. For the assets where the condition of extra shift depreciation does not exist, the Company will be eligible to claim 50% extra depreciation as per schedule II.

   (c) As the Schedule III is applicable for the whole Company, the policy including useful life for the assets need to be same. There cannot be different useful lives for different assets across different locations. Thus, the depreciation policy of the Company is good to go.

   (d) As the Company is operating the plant 24*7, it will be referred to as continuous process plant. For the assets where the condition of extra shift depreciation does not exist, the Company will not be eligible to claim 100% extra depreciation as per Schedule II.

10. The audit team has raised a question over hiring an international brand ambassador for an Indian product and raised concerns over the contract of the same:

    (a) The auditor has no role to play in such scenario as the selection of brand ambassador and the running the business lies with the management. The auditor needs to go through the agreements entered, payments made etc.

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(b) The auditor needs to inform the Central Government as this might constitute a serious non-compliance of laws and regulations. The auditor should also assess the integrity of the management about the appointment of the foreign brand ambassador.

(c) As per the SA 250, "Consideration of laws and regulations in an audit of Financials Statements" the auditor needs to assess such matters as it is a legal violation to hire an international brand ambassador ignoring the local people. The audit team need to consider the same and report in its audit report about such implications.

(d) The auditor needs to qualify its audit report as the Company is against the "Vocal for Local" policy. The auditor needs to highlight the same in its audit report as this may lead to a serious brand deterioration of the Company.

Independent MCQs

11. Anant & Co. is the auditor of ST Insurance Company. The insurance company is also involved in re-insurance business and necessary provision for re-insurance premium has been made in the books of accounts. The insurance company is into a re-insurance whereby their contract relates to one particular risk and is expressed in the re-insurance policy. Each transaction is negotiated individually, and each party has a free choice i.e. for the insurance company to offer and the re-insurer to accept. What kind of a re-insurance business is the insurance company into?

(a) Facultative Re-insurance.

(b) Stop loss treaty re-insurance.

(c) Auto-fac re-insurance.

(d) Proportional treaty re-insurance.

12. Below is an extract from the list of supplier statements as at 31st March 2020 held by the Company and corresponding payables ledger balances at the same date along with some commentary on the noted differences:

Supplier	***Statement balance ₹'000***	***Payables ledger balance ₹'000***
Cete Company	80	60
Lice Company	185	115

The difference in the balance of **Cete Company** is due to an invoice which is under dispute due to defective goods which were returned on 30th March 2020. **Which of the following audit procedures should be carried out to confirm the balance owing to Cete Company?**

(I) Review post year-end credit notes for evidence of acceptance of return.

(II) Inspect pre year-end goods returned note in respect of the items sent back to the supplier.

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(III) Inspect post year-end cash book for evidence that the amount has been settled.

(a) 1, 2 and 3.

(b) 1 and 3 only.

(c) 1 and 2 only.

(d) 2 and 3 only.

PART B : DESCRIPTIVE QUESTIONS

Standards on Auditing, Statements and Guidance Notes

13. (a) Coccyx Ltd. supplies navy uniforms across the country. The Company has 3 warehouses at different locations throughout the India and 5 warehouses at the borders. The major stocks are generally supplied from the borders. Coccyx Ltd. appointed M/s OPAQE & Co. to conduct its audit for the financial year 2020-21. Mr. P, partner of M/s OPAQE & Co., attended all the physical inventory counting conducted throughout the India but could not attend the same at borders due to some unavoidable reason.

You are required to advise M/s OPAQE & Co.,

(I) How sufficient appropriate audit evidence regarding the existence and condition of inventory may be obtained?

(II) How is an auditor supposed to deal when attendance at physical inventory counting is impracticable?

(b) CA. Dev, a recently qualified practicing Chartered Accountant got his first internal audit assignment of a large manufacturing concern Growth Limited. As an internal auditor for Growth Limited, CA. Dev is required to verify whether there are adequate records for identification and value of Plant and Machinery, tools and dies and whether any of these items have become obsolescent and not in use. Draft a suitable audit programme for the above.

(c) (I) In an initial audit engagement, the auditor will have to satisfy about the sufficiency and appropriateness of 'Opening Balances' to ensure that they are free from misstatements, which may materially affect the current financial statements. Lay down the audit procedure, you will follow in cases (i) when the financial statements are audited for the preceding period by another auditor; and (ii) when financial statements are audited for the first time.

(II) If, after performing the procedure, you are not satisfied about the correctness of 'Opening Balances'; what approach you will adopt in drafting your audit report in two situations mentioned in (I) above?

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The Company Audit & Audit Report

14. Star Ltd. is a power generating company which uses coal as raw material for its power generating plant. The Company has been allotted coal blocks in the state of Jharkhand and Odisha. During the FY 2020-21, a scam regarding allotment of coal blocks was unveiled leading to a ban on the allotment of coal blocks to various companies including Star Ltd. This happened in the month of December 2020 and as such entire power generation process of Star Ltd, came to a halt in that month. As a result of such ban, and the resultant stoppage of the production process, many key managerial personnel of the company left the Company. There were delays in the of payment of wages and salaries and the banks from whom the Company had taken funds for project financing also decided not to extend further finance or to fund further working capital requirements of the Company.

    Further, when discussed with the management, the statutory auditor understood that the Company had no action plan to mitigate such circumstances. Further, all such circumstances were not reflected the financial statements of Star Ltd. What course of action should the statutory auditor of the Company consider in such situation?

Audit Committee and Corporate Governance

15. Mr. Ibrahim was appointed as statutory auditor of New Limited and Old Limited. Both the Companies were having their base in Chennai they had recently listed their shares on the Stock Exchange. For the financial year 2020-21, Mr. Ibrahim had signed limited review reports for each quarter, till the quarter ended 31st December 2020 for both the companies. Owing to his personal commitments and increased workload, he tendered his resignation to M/s New Limited on 30th January 2021 and asked the Company to appoint another auditor to issue audit report for the remaining quarter and the FY 2020-21 as a whole. But the management of the Company did not accept the same.

    Mr. Ibrahim continued to as act as auditor for M/s Old limited. During the 1st week of March 2021, Mrs. W (wife of Mr. Ibrahim) had borrowed a sum of ₹ 6 lakh from the Company for her personal use. Having come to know about this, Mr. Ibrahim immediately informed the management that he had been disqualified to act as auditor and told them that he won 't issue audit report for last quarter. But management of the Company argued that it's the legal responsibility of Mr. Ibrahim to do the same.

    Whether contention of management of New Limited and Old Limited is justified in asking Mr. Ibrahim to issue audit report for the last quarter and the FY 2020-21 as a whole, despite his resignation? Discuss.

Audit of Banks & Insurance Company

16. (a) You are auditing a small bank branch with staff strength of the manager, cashier and three other staff Peter, Prem and Pran. Among allocation of work for other areas, Peter who is a peon also opens all the mail and forwards it to the concerned person. He does not have a signature book so as to check the signatures on important

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communications. Prem has possession of all bank forms (e.g. Cheque books, demand draft/pay order books, travelers' cheques, foreign currency cards etc.). He maintains a record meticulously which you have test checked also. However, no one among staff regularly checks that. You are informed that being a small branch with shortage of manpower, it is not possible to always check the work and records. Give your comments.

(b) As at 31st March 2020 while auditing Universe Insurance Ltd, you observed that a policy has been issued on 27th March 2020 for fire risk favouring one of the leading corporate houses in the country without the actual receipt of premium and it was reflected as premium receivable. The Company maintained that it is a usual practice in respect of big customers and the money was collected on 7th April, 2020. You further noticed that there was a fire accident in the premises of the insured on 31st March 2020 and a claim was lodged for the same. The insurance company also made a provision for claim. Please respond.

Audit under Fiscal Laws

17. (a) Arihant Pvt Ltd is engaged in the business of providing corporate/professional training programs. It has an annual turnover of INR 74 crore. The Company is subject to tax audit for which the work has been started by the tax auditor. For the financial year ending 31 March 2021, the Company applied for GST registration for 5 new locations for which registration certificates have not yet been received by the Company. However, the registration number is available on the portal of relevant authority which can be verified by checking the details of the Company. In this case what should be the audit procedures to verify this registration number?

(b) Mr. Rohan, made an outward supply of ₹ 4.00 lakh to M/s. Park Enterprises on 30th April, 2020 on a credit period of 15 days. However, M/s Park Enterprises made the payment to Mr. Rohan after 45 days along with interest for 30 days delayed payment @ 12%. As such, Mr. Rohan received total payment of ₹ 4,04,000/- along with interest. However, while filing Form GSTR-3B/ Form GSTR-1, Mr. Rohan declared his outward supplies at ₹ 4.00 lakh. Even while filing Form GSTR-9, Mr. Rohan did not discharge his tax liability. As a GST auditor in Form GSTR-9C, what action is recommended by the auditors. Comment.

Internal Audit, Management Audit and Operational Audit

18. M/s Raka & Co., Chartered Accountants have been approached by Abhinandan Ltd., a company engaged in iron and steel manufacturing industry. The Company has been facing following operational issues:

(a) Penal interest for delayed payments to the overseas vendors despite having enough cash flows; and

(b) Despite having regular production and enough inventory, delays in shipping the final goods to the customers leading to its deteriorating vendor rating.

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As a partner of M/s Raka & Co., through detailed discussion with the Senior Manager of Abhinandan Ltd., you have concluded that all these delays are because of long decision-making cycles in the Company. As a consultant to the Company, would you recommend Management Audit or Operational Audit?

Professional Ethics

19. Comment on the following with reference to the Chartered Accountants Act, 1949 and schedules thereto:

    (a) C.A. Ajitnath is Special Executive Magistrate. He also took over as the Executive Chairman of Software Company on 1.4.2020. He is also a leading income tax practitioner and consultant for derivative products. He resides in Chennai near to the ION commodity stock exchange and does trading in commodity derivatives. Every day, he invests nearly 40% of his time to settle the commodity transactions. He has not taken any permission for becoming Special Executive Magistrate. However, he has got special permission of Council of ICAI for becoming Executive Chairman. Is C.A. Ajitnath liable for professional misconduct?

    (b) CA. Sambhav, the auditor of Mahvir Pvt. Ltd. has delegated following works to his articles and staff:

    - ❖ Raising of bills and issuing acknowledgements for money receipts.
    - ❖ Initiating and stamping of vouchers and of schedules prepared for the purpose of audit.
    - ❖ Issuing acknowledgements for records produced.
    - ❖ Signing financial statements of the company.

    Is this correct as per the Professional Ethics and ICAI's guidelines and pronouncements?

20. Write a short note on the following:

    (a) Technical, Ethical and Professional Standards as per Statement on Peer Review.

    (b) Important issues to be kept in mind by the investigator while preparing his report.

    (c) Direction by Tribunal in case auditor acted in a fraudulent manner.

    (d) Differences between Division II (Ind- AS- Other than NBFCs) and Division III (Ind-AS- NBFCs) of Schedule III.

    (e) Technology based /Digital Forensics Techniques.

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SUGGESTED ANSWERS

PART A : ANSWERS TO MULTIPLE QUESTIONS

1. (c)

2. (b)

3. (b)

4. (d)

5. (b)

6. (c)

7. (d)

8. (c)

9. (d)

10. (a)

11. (a)

12. (c)

PART B

13. (a) (I) Special Consideration with Regard to Inventory: As per SA 501 "Audit Evidence- Specific Considerations for Selected Items", when inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by:

(1) Attendance at physical inventory counting, unless impracticable, to:

- (i) Evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting;
- (ii) Observe the performance of management's count procedures;
- (iii) Inspect the inventory; and
- (iv) Perform test counts; and

(2) Performing audit procedures over the entity's final inventory records to determine whether they accurately reflect actual inventory count results.

(II) Attendance at Physical Inventory Counting Not Practicable: In some cases, attendance at physical inventory counting may be impracticable. This may be due to factors such as the nature and location of the inventory, for example, where inventory is held in a location that may pose threats to the safety of the

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auditor. The matter of general inconvenience to the auditor, however, is not sufficient to support a decision by the auditor that attendance is impracticable. Further, as explained in SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive.

Further, where attendance is impracticable, alternative audit procedures, for example, inspection of documentation of the subsequent sale of specific inventory items acquired or purchased prior to the physical inventory counting, may provide sufficient appropriate audit evidence about the existence and condition of inventory.

In some cases, though, it may not be possible to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by performing alternative audit procedures. In such cases, SA 705 on Modifications to the Opinion in the Independent Auditor's Report, requires the auditor to modify the opinion in the auditor's report as a result of the scope limitation.

(b) The Internal Audit Programme in connection with Plant and Machinery and Tools and dies may be on the following lines:

(i) **Internal Control Aspects:** The following may be incorporated in the audit programme to check the internal control aspects-

(a) Maintaining separate register for hired assets, leased asset and jointly owned assets.

(b) Maintaining register of fixed asset and reconciling to physical inspection of fixed asset and to nominal ledger.

(c) All movements of assets are accurately recorded.

(d) Authorisation be obtained for –

(1) a declaring a fixed asset scrapped.

(2) selling a fixed asset.

(e) Check whether additions to fixed asset register are verified and checked by authorised person.

(f) Proper recording of all additions and disposal.

(g) Examining procedure for the purchase of new fixed assets, including written authority, work order, voucher and other relevant evidence.

(h) Regular review of adequate security arrangements.

(i) Periodic inspection of assets is done or not.

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(j) Regular review of insurance cover requirements over fixed assets.

(ii) **Assets Register:** To review the registers and records of plant, machinery, etc. showing clearly the date of purchase of assets, cost price, location, depreciation charged, etc.

(iii) **Cost Report and Journal Register:** To review the cost relating to each plant and machinery and to verify items which have been capitalised.

(iv) **Code Register:** To see that each item of plant and machinery has been given a distinct code number to facilitate identification and verify the maintenance of Code Register.

(v) **Physical Verification:** To see physical verification has been conducted at frequent intervals.

(vi) **Movement Register:** To verify (a) whether Movement Register for movable equipments and (b) log books in case of vehicles, etc. are being maintained properly.

(vii) **Assets Disposal Register:** To review whether assets have been disposed off after proper technical and financial advice and sales/disposal/retirement, etc. of these assets are governed by authorisation, sales memos or other appropriate documents.

(viii) **Spare Parts Register:** To examine the maintenance of a separate register of tools, spare parts for each plant and machinery.

(ix) **Review of Maintenance:** To scrutinise the programme for an actual periodical servicing and overhauling of machines and to examine the extent of utilisation of maintenance department services.

(x) **Review of Obsolescence:** To scrutinise whether expert's opinion have been obtained from time to time to ensure purchase of technically most useful efficient and advanced machinery after a thorough study.

(xi) **Review of R&D:** To review R&D activity and ascertain the extent of its relevance to the operations of the organisation, maintenance of machinery efficiency and prevention of early obsolescence.

(c) (I) (i) Financial Statements Audited by another Auditor – Audit Procedure: If the prior period's financial statements were audited by a predecessor auditor, the auditor may be able to obtain sufficient appropriate audit evidence regarding the opening balances by perusing the copies of the audited financial statements including the other relevant documents relating to the prior period financial statements such as supporting schedules to the audited financial statements. Ordinarily, the current auditor can place reliance on the closing balances contained in the financial statements for the preceding period, except when during the performance

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of audit procedures for the current period the possibility of misstatements in opening balances is indicated.

(ii) **Audit of Financial Statements for the First Time – Audit Procedure:** When the audit of financial statements is being conducted for the first time, the auditor has to perform auditing procedures to obtain sufficient appropriate audit evidence. Since opening balances represent effect of transaction and events of the preceding period and accounting policies applied in the preceding period, the auditor need to obtain evidence having regard to nature of opening balances, materiality of the opening balances and accounting policies. Since it will not be possible for auditor to perform certain procedures, e.g., observing physical verification of inventories, etc. the auditor may obtain confirmation, etc. and perform suitable procedures in respect of fixed assets, investments, etc. The auditor can also obtain management representation with regards to the opening balances.

(II) **Drafting Audit Report:** If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall express a qualified opinion or a disclaimer of opinion, as appropriate. Further, If the auditor concludes that the opening balances contain a misstatement that materially affects the current period's financial statements, and the effect of the misstatement is not properly accounted for or not adequately presented or disclosed, the auditor shall express a qualified opinion or an adverse opinion.

14. SA 570- "Going Concern" deals with the auditor's responsibilities in the audit of financial statements relating to going concern and the implications for the auditor's report.

The auditor's responsibilities are to obtain sufficient appropriate audit evidence regarding, and conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements, and to conclude, based on the audit evidence obtained, whether a material uncertainty exists about the entity's ability to continue as a going concern.

When the use of going concern basis of accounting is inappropriate i.e., if the financial statements have been prepared using the going concern basis of accounting but, in the auditor's judgment, management's use of the going concern basis of accounting in the preparation of the financial statements is inappropriate, the auditor shall express an adverse opinion.

Also, when adequate disclosure of a material uncertainty is not made in the financial statements the auditor shall express a qualified opinion or adverse opinion, as appropriate, in accordance with SA 705 (Revised); and in the Basis for Qualified (Adverse) Opinion section of the auditor's report, state that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter.

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In the present case, the following circumstances indicate the inability of Star Ltd. to continue as a going concern:

- Ban on the allotment of coal blocks
- Halt in power generation
- Key Managerial Personnel leaving the Company.
- Banks decided not to extend further finance and not to fund the working capital requirements of the Company.
- Non availability of sound action plan to mitigate such circumstances.

Therefore, considering the above factors it is clear that the going concern basis is inappropriate for the Company. Further, such circumstances are not reflected in the financial statements of the Company. As such, the statutory auditor of Star Ltd. should:

(1) Express an adverse opinion in accordance with SA 705 (Revised) and

(2) In the Basis of Opinion paragraph of the auditor's report, the statutory auditor should state that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter.

15. In the given scenario, Mr. Ibrahim was appointed as statutory auditor of two listed entities i.e., New Limited and Old Limited. For the financial year 2020-21, Mr. Ibrahim had signed limited review reports for first three quarter i.e., till the quarter ended 31st December 2020 for both the companies. Owing to his personal commitments and increased workload, he resigned from New Limited and asked the Company to appoint another auditor to issue audit report for the remaining quarter and audit report for the FY 2020-21.

Further, Mr. Ibrahim immediately informed the management of Old Limited that he had been disqualified to act as auditor and told them that he won't issue audit report for last quarter as Mrs. W (wife of Mr. Ibrahim) had borrowed a sum of ₹ 6 lakh from the Company for her personal use.

As per SEBI LODR Regulations, if the auditor has signed the limited review/ audit report for the first three quarters of a financial year, then the auditor shall, before such resignation, issue the limited review/ audit report for the last quarter of such financial year as well as the audit report for such financial year. This provision will not apply if the auditor is disqualified due to Section 141 of the Companies Act, 2013.

Thus, in the given situation, in view of above conditions to be complied with upon resignation of the statutory auditor of a listed entity/material subsidiary with respect to limited review / audit report as per SEBI LODR Regulations, Mr. Ibrahim is required to issue the audit report for the last quarter and audit report for the year 2020-21 for New Limited as he has issued audit report for the first three quarters whereas Mr. Ibrahim is not

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required to issue the audit report for remaining quarter and audit report for the year 2020-21 as a whole for Old Limited as he is disqualified under section 141 of Companies Act.

Accordingly, contention of Management of New Limited is correct and tenable for issuing the audit report for remaining quarter and audit report for financial year 2020-21 however, contention of management of Old Limited is not correct regarding the legal responsibility of Mr. Ibrahim to issue audit report for remaining quarter and for the whole year.

16. (a) Banks are required to implement and maintain a system of internal controls for mitigating risks, maintain good governance and to meet the regulatory requirements. Given below are examples of internal controls that are violated in the given situation:

In the instant case, Peter who is a peon opens all the mail and forwards it to the concerned person. Further, he does not have a signature book so as to check the signatures on important communications is not in accordance with implementation and maintenance of general internal control. As the mail should be opened by a responsible officer. Signatures on all the letters and advices received from other branches of the bank or its correspondence should be checked by an officer with the signature book.

All bank forms (e.g. Cheque books, demand draft/pay order books, travelers' cheques, foreign currency cards etc.) should be kept in the possession of an officer, and another responsible officer should verify the issuance and stock of such stationery. In the given case, Prem has possession of all bank forms (e.g. cheque books, demand draft/pay order books, travelers' cheques, foreign currency cards etc.). He maintains a record meticulously which were also verified on test check basis.

Further, contention of bank that being a small branch with shortage of manpower they are not able to check the work and records on regular basis, is not tenable as such lapses in internal control pose risk of fraud.

The auditor should report the same in his report accordingly.

(b) No risk can be assumed by the insurer unless the premium is received. According to section 64VB of the Insurance Act, 1938, no insurer should assume any risk in India in respect of any insurance business on which premium is ordinarily payable in India unless and until the premium payable is received or is guaranteed to be paid by such person in such manner and within such time, as may be prescribed, or unless and until deposit of such amount, as may be prescribed, is made in advance in the prescribed manner. The premium receipt of insurance companies carrying on general insurance business normally arise out of three sources, viz., premium received from direct business, premium received from reinsurance business and the share of co-insurance premium.

In view of the above, the insurance company is not liable to pay the claim and hence no provision for claim is required.

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17. (a) Clause (4) (Details as to Indirect Tax Registration) of Part A of Form No. 3CD generally requires the auditor to ensure whether the assessee is liable to pay indirect tax like excise duty, service tax, sales tax, goods and service tax, custom duty, etc. If yes, please furnish the registration number or GST number or any other identification number allotted for the same. Thus, the auditor is primarily required to furnish the details of registration numbers as provided to him by the assessee. The reporting is required to be done in the manner or format specified by the e-filing utility in this context.

In the given situation, Arihant Pvt Ltd is engaged in the business of providing corporate/professional training programs. The Company is subject to tax audit. For the financial year ending 31 March 2021, the Company applied for GST registration for 5 new locations for which registration certificates have not yet been received by the Company. However, the registration number is available on the portal of relevant authority.

In the instant case, the tax auditor of Arihant Private Limited should verify the registration number for the locations for which registration certificates have not been received from online portal of the relevant authority.

The auditor should also ensure that the details furnished while checking the registration number pertains to the company only. If the company has filed any returns for these locations, the auditor should enquire for the same from the management and should check those returns to verify the correctness of the registration numbers. In addition, the auditor should also obtain specific representation in respect of this point from the management.

(b) In terms of section 15(2)(d) while computing value of taxable supply the transaction value shall include interest or late fee or penalty for delayed payment of any consideration for any supply. Since, Mr. Rohan did not pay tax on interest component, he made violation of valuation provisions. Mr. John was having option to discharge such liability at the time of filing of Form GSTR-9, which he did not avail. Therefore, the GST auditor may recommend him to discharge such liability at the time of making reconciliation statement in Form GSTR-9C.

18. A comparison between the Management Audit & the Operational Audit is as follows:

Management audit is concerned with the "Quality of managing", whereas operational audit focuses on the "Quality of operations".

Management audit is the "Audit of management" while the operational audit is the "Audit for the management". The focus of Management Audit is on "Quality of Decision Making" rather than the effectiveness or efficiency of operations.

The basic difference between the two audits, then, is not in method, but in the level of appraisal. In a management audit, the auditor is to make his tests to the level of top management, its formulation of objectives, plans and policies and its decision making. It is

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not that he just verifies the operations of control and procedures and fulfilment of plans in conformity with the prescribed policies.

Since, the delays in payments and consequent penal interest payments and the delays in shipping and the consequent deteriorating vendor ratings are happening because of the delays in decision-making process of the management of Abhinandan Ltd. Therefore, it appears that this is not just an internal control or operational issue but an issue of management process.

Therefore, Management Audit would be recommended in this case.

19. (a) Engaging into a Business: As per Clause (11) of Part I of First Schedule of Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he engages in any business or occupation other than the profession of Chartered Accountant unless permitted by the Council so to engage.

However, the Council has granted general permission to the members to engage in certain specific occupation. In respect of all other occupations specific permission of the Institute is necessary.

In this case, C.A. Ajitnath is Special Executive Magistrate, engaged in the occupation of trading in commodity derivatives and also took over as the Executive Chairman on 01.04.2020.

In this context, it may be noted that the Special Executive Magistrate which is generally permitted for Members of the Institute in practice, further specific permission is required for holding the position of Executive Chairman and getting engaged in the occupation of trading in commodity derivatives.

In the given situation, C.A. Ajitnath is acting as Special Executive Magistrate which is generally permitted for Members of the Institute in practice. Further, He is engaged in the occupation of trading in commodity derivatives which is not covered under the general permission. He also took over as the Executive Chairman for which specific permission is required. CA. Ajitnath got the permission for the same from the Council of ICAI.

Conclusion: Hence, CA. Ajitnath is not guilty for acting as Special Executive Magistrate as it is covered under the general permission. He is also not guilty for holding the position of Executive Chairman after getting specific permission of the Institute.

However, he is guilty of professional misconduct under Clause (11) of Part I of First Schedule of Chartered Accountants Act, 1949 for getting engaged in the occupation of trading in commodity derivatives which is not covered under the general permission.

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(b) As per Clause (12) of Part I of the First Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he allows a person not being a member of the institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, any balance sheet, profit and loss account, report or financial statements.

The Council has clarified that the power to sign routine documents on which a professional opinion or authentication is not required to be expressed may be delegated in the following instances and such delegation will not attract provisions of this clause:

(i) Issue of audit queries during the course of audit.

(ii) Asking for information or issue of questionnaire.

(iii) Letter forwarding draft observations/financial statements.

(iv) Initiating and stamping of vouchers and of schedules prepared for the purpose of audit.

(v) Acknowledging and carrying on routine correspondence with clients.

(vi) Issue of memorandum of cash verification and other physical verification or recording the results thereof in the books of the clients.

(vii) Issuing acknowledgements for records produced. Raising of bills and issuing acknowledgements for money receipts.

(ix) Attending to routine matters in tax practice, subject to provisions of Section 288 of Income Tax Act.

(x) Any other matter incidental to the office administration and routine work involved in practice of accountancy.

In the instant case, CA. Sambhav, the auditor of Mahvir Pvt. Ltd. has delegated certain task to his articles and staff such as raising of bills and issuing acknowledgements for money receipts, initiating and stamping of vouchers and of schedules prepared for the purpose of audit and issuing acknowledgements for records produced and signing financial statements of the company.

Therefore, CA. Sambhav is correct in allowing first three tasks i.e., raising of bills and issuing acknowledgements for money receipts, initiating and stamping of vouchers and of schedules prepared for the purpose of audit.

However, if the person signing the financial statements on his behalf is not a member of the institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, CA. Sambhav is not right in delegating signing of financial statements to his staff.

Conclusion: In view of this, CA. Sambhav would be guilty of professional misconduct for allowing the person signing the financial statements on his behalf to his articles

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and staff under Clause 12 of Part 1 of First Schedule of the Chartered Accountants Act, 1949.

20. (a) As per the Statement on Peer Review, Technical, Professional and Ethical Standards means:

(i) Accounting Standards issued by ICAI that are applicable for entities other than companies under the Companies Act, 2013;

(ii) Accounting Standards prescribed under section 133 of the Companies Act; 2013 by the Central Government based on the recommendation of ICAI and in consultation with the National Financial Reporting Authority (NFRA) and notified as Accounting Standards Rules 2006, as amended from to time;

(iii) Indian Accounting Standards prescribed under section 133 of the Companies Act 2013 by the Central Government based on the recommendation of ICAI and in consultation with NFRA and notified as Companies (Indian Accounting Standards) Rules, 2015, as amended from time to time;

(iv) Standards :

Standards issued by the Institute of Chartered Accountants of India including-
(a) Engagement standards (b) Statements (c) Guidance notes (d) Standards on Internal Audit. (e) Guidelines/ Notifications / Directions / Announcements / Pronouncements / Professional Standards issued from time to time by the Council or any of its Committees.

(v) Framework for the preparation and presentation of financial statements, Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services and Framework for Assurance engagements;

(vi) Provisions of the relevant statutes and / or rules or regulations which are applicable in the context of the specific engagements being reviewed including instructions, guidelines, notifications, directions issued by regulatory bodies as covered in the scope of assurance engagements.

(b) The important issues to be kept in mind by the investigator while preparing his report are as follows:

(i) The report should not contain anything which is not relevant either to highlight the nature of the investigation or the final outcome thereof.

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(ii) Every word or expression used should be properly considered so that the possibility of arriving at a different meaning or interpretation other than the one intended by the investigator can be minimized.

(iii) Relevant facts and conclusions should be properly linked with evidence.

(iv) Bases and assumptions made should be explicitly stated. Reasonableness of the bases and assumptions made should be well examined and care should be taken to see that none of the bases and assumptions can be considered to be in conflict with the objective of the investigation. For example, in an investigation into over-stocking of raw materials, inventories and spares etc. it should not be assumed that the ordering levels indicated on bin cards provide fair guidance about acquisition of further materials. Also, since investigation is a fact-finding assignment, assumptions should be made only when it is unavoidably necessary.

(v) The report should clearly spell out the nature and objective of the assignment accepted its scope and limitations, if any.

(vi) The report should be made in paragraph form with headings for the paragraphs. Any detailed data and figures supporting any finding may be given in Annexures.

(vii) The report should also state restrictions or limitations, if any, imposed on the instructions given by the client. Preferably the reasons for placing such restrictions and their impact on the final result should also be stated.

(viii) The opinion of the investigator should appear in the final paragraph of the report.

(c) Direction by Tribunal in case auditor acted in a fraudulent manner: As per sub-section (5) of the section 140, the Tribunal either *suo motu* or on an application made to it by the Central Government or by any person concerned, if it is satisfied that the auditor of a company has, whether directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers, it may, by order, direct the company to change its auditors.

However, if the application is made by the Central Government and the Tribunal is satisfied that any change of the auditor is required, it shall within fifteen days of receipt of such application, make an order that he shall not function as an auditor and the Central Government may appoint another auditor in his place.

It may be noted that an auditor, whether individual or firm, against whom final order has been passed by the Tribunal under this section shall not be eligible to be appointed as an auditor of any company for a period of five years from the date of passing of the order and the auditor shall also be liable for action under section 447.

It is hereby clarified that the case of a firm, the liability shall be of the firm and that of every partner or partners who acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its director or officers.

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(d) Differences between Division II (Ind- AS- Other than NBFCs) and Division III (Ind- AS- NBFCs) of Schedule III: The presentation requirements under Division III for NBFCs are similar to Division II (Non NBFC) to a large extent except for the following:

(i) NBFCs have been allowed to present the items of the balance sheet in order of their liquidity which is not allowed to companies required to follow Division II. Additionally, NBFCs are required to classify items of the balance sheet into financial and non-financial whereas other companies are required to classify the items into current and non-current.

(ii) An NBFC is required to separately disclose by way of a note any item of 'other income' or 'other expenditure' which exceeds 1 per cent of the total income. Division II, on the other hand, requires disclosure for any item of income or expenditure which exceeds 1 per cent of the revenue from operations or ₹ 10 lakh, whichever is higher.

(iii) NBFCs are required to separately disclose under 'receivables', the debts due from any Limited Liability Partnership (LLP) in which its director is a partner or member.

(iv) NBFCs are also required to disclose items comprising 'revenue from operations' and 'other comprehensive income' on the face of the Statement of profit and loss instead of showing those only as part of the notes.

(v) Separate disclosure of trade receivable which have significant increase in credit risk & credit impaired.

(vi) The conditions or restrictions for distribution attached to statutory reserves have to be separately disclose in the notes as stipulated by the relevant statute.

(e) 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. However, many open-source digital forensics tools are now available to assist in this phase of the investigation.

Cross Drive Analysis	EnCase
Live Analysis	MD5
Deleted Files	Tracking Log Files
Stochastic Forensics	PC System Log
Steganography	Free Log Tools

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PAPER 4: CORPORATE AND ECONOMIC LAWS

PART – I: RELEVANT MATERIALS FOR MAY 2021 EXAMINATION

For May 2021 examinations for Paper 4: Corporate and Economic Laws, relevant material is of November 2020 edition containing relevant amendments made latest by 31st October 2020.

Besides, refer booklet on MCQS and Case scenarios of January 2021 edition containing Independent MCQs and Case Scenarios on the topics covered under the study material for 30 marks segment of MCQs in the Examination.

Read thoroughly the study material first and then go with the said booklet to have practice and revision of concepts with an analytical and application approach with the thorough understanding of the subject.

PART – II : QUESTIONS AND ANSWERS

DIVISION A: CASE SCENARIO BASED MCQS/ INDEPENDENT MULTIPLE CHOICE QUESTIONS

Case scenario 1

Balfor Ltd., is an unlisted company, having total 70 members, with a paid up capital of ₹ 42,00,000, having turnover of ₹ 200 crore, as per the audited financial statements for the year ended on 31st March, 2020.

5 members holding in total 4% stake in the company, met in person to discuss about the oppression and mismanagement going on in Balfor Ltd. and to do something about it. One of the members, Mr. Ravi, suggested that we five members should file a class action application to the Tribunal to get a resolution in this matter, to which another member, Mr. Jay, told that he is in contact with 3 other members of the company, holding in total 3% stake, who are also finding the activities going on in the company to be unjust. So, five plus three other members i.e. 8 members in total, will be able to file an application to the Tribunal under section 244 of the Companies Act, 2013.

The application of complaint for oppression and mismanagement was filed to the Tribunal on 4th June, 2020, with the consent of aforesaid 8 members of the company. The said application provided the details of an agreement made by Balfor Ltd. with Mr. Dev, a relative of director of Balfor Ltd., Mr. Raj, with respect to continuous supply of raw materials to Balfor Ltd., for which Mr. Raj, had received certain commission from Mr. Dev, in cash, for offering the contract to him. Also, another director, Mr. Jayesh, had improperly transferred a property of Balfor Ltd. on 6th March, 2020, to Mr. Prakash.

The Tribunal on receipt of such application, made an order, directing investigation into the affairs of Balfor Ltd. Also, the agreement made with Mr. Dev was ordered to be terminated after giving notice to Mr. Dev and obtaining his consent. However, no compensation was ordered to be paid to Mr. Dev for such cancellation of agreement. The contract with respect to property transferred

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by Mr. Jayesh was also ordered to be set aside, as it would have been deemed to be a fraudulent preference, in case such transaction was made by an individual in his insolvency.

Simultaneously, the Central Government ordered for the investigation into the affairs of Balfor Ltd., on receipt of the order from the Tribunal and the task of such investigation was assigned to the Serious Fraud Investigation Office. The Director of Serious Fraud Investigation Office, on getting such order from the Central Government, designated 3 inspectors for such investigation and soon, the investigation got started by the designated persons.

One of the Investigating officers, Mr. Vaibhav, issued summons, to 2 employees, of Balfor Ltd., Mr. Karan and Mr. Arjun, respectively, as well as, to Mr. Daya, an employee of Kafor Ltd., an associate company of Balfor Ltd., after taking the requisite approvals.

The aforesaid persons attended at the place at which they were summoned by Mr. Vaibhav and were examined on oath, one after the other. During the said examination, Mr. Vaibhav, took down notes in writing and he read over the notes taken by him, to all the persons examined, after the end of examination. After hearing the said notes, Mr. Karan and Mr. Arjun, signed the document on which such notes were written but Mr. Daya, refused to sign such document without any reasonable cause for the same, on the same day, but then he thought there would be no issue in signing and so he signed the same after 20 days.

Mr. Vaibhav, forwarded the notes taken by him to the Assistant Director of Serious Fraud Investigation Office, Mr. Ramanuj, and on the basis of such notes, he derived that Mr. Arjun has committed an offence under section 447 of the Companies Act, 2013 which Mr. Ramanuj reconfirmed with Mr. Vaibhav, via email.

Mr. Ramanuj, accordingly, passed an order for arrest of Mr. Arjun, after recording in writing the reasons for such arrest and he immediately forwarded the copy of order of such arrest to the concerned authority along with the document containing notes taken by Mr. Vaibhav at the time of examination of Mr. Arjun, which indicated that he has committed an offence under section 447 of the Companies Act, 2013.

Balfor Ltd., on coming to know of such arrest of Mr. Arjun, wanted to give termination to him and also wanted to demote Mr. Karan to position of junior assistant from his position of senior assistant in the company, during the pendency of investigation and for that purpose it made an application to the Tribunal for the same on 10th October, 2020.

In response to the said application from Balfor Ltd., the Tribunal passed an order on 26th October, 2020 allowing the termination to be given to Mr. Arjun but it objected to the decision of the company for reduction in rank of Mr. Karan from his current position, against which Balfor Ltd. filed an application with the appellate tribunal on 15th November, 2020.

Multiple Choice Questions:

1. State in the light of the given facts , whether, the five members holding in total 4% stake in Balfor Ltd., or the eight members, holding in total 7% stake in Balfor Ltd., were eligible for filing application for class action or/ and u/s 244, respectively, of the Companies Act, 2013?

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(a) For filing application for class action, 5 members were eligible and also for filing application u/s 244 of the Companies Act, 2013, 8 members were eligible.

(b) For filing application for class action, 5 members were not eligible and also for filing application u/s 244 of the Companies Act, 2013, 8 members were not eligible.

(c) For filing application for class action, 5 members were eligible but for filing application u/s 244 of the Companies Act, 2013, 8 members were not eligible.

(d) For filing application for class action, 5 members were not eligible but for filing application u/s 244 of the Companies Act, 2013, 8 members were eligible.

2. Whether the decision of Tribunal can be considered as valid with respect to termination of agreement made by Balfor Ltd. with Mr. Dev as well as setting aside the contract of transfer of property, respectively?

   (a) The decision of tribunal for termination of agreement made by Balfor Ltd. with Mr. Dev can be considered as valid. Also, the decision of setting aside the contract of transfer of property, can be considered as valid as such transfer was made within 6 months before the date of making application to the tribunal.

   (b) The decision of tribunal for termination of agreement made by Balfor Ltd. with Mr. Dev cannot be considered as valid as no compensation was ordered to be paid to Mr. Dev. Also, the decision of setting aside the contract of transfer of property, cannot be considered as valid as such transfer was not made within 90 days before the date of making application to the tribunal.

   (c) The decision of tribunal for termination of agreement made by Balfor Ltd. with Mr. Dev can be considered as valid. Also, the decision of setting aside the contract of transfer of property, can be considered as valid as such transfer was made within 3 months before the date of making application to the tribunal.

   (d) The decision of tribunal for termination of agreement made by Balfor Ltd. with Mr. Dev cannot be considered as valid as no compensation was ordered to be paid to Mr. Dev. However, the decision of setting aside the contract of transfer of property, can be considered as valid as such transfer was made within 3 months before the date of making application to the tribunal.

3. Prior approval of which authority would have been sufficient for Mr. Vaibhav for examining Mr. Daya, on oath, and how much maximum amount of fine could be levied on Mr. Daya for refusing to sign the document containing the notes taken down by Mr. Vaibhav?

   (a) Prior approval of Director of Serious Fraud Investigation Office would have been sufficient for Mr. Vaibhav and maximum amount of fine that could be levied on Mr. Daya is ₹ 1,00,000.

   (b) Prior approval of Central Government would have been sufficient for Mr. Vaibhav and maximum amount of fine that could be levied on Mr. Daya is ₹ 40,000.

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(c) Prior approval of Director of Serious Fraud Investigation Office would have been sufficient for Mr. Vaibhav and maximum amount of fine that could be levied on Mr. Daya is ₹ 1,40,000.

(d) Prior approval of Central Government would have been sufficient for Mr. Vaibhav and no fine that could be levied on Mr. Daya as he has signed the said document within 30 days of being examined on oath.

4. Whether Mr. Ramanuj was having the authority to exercise power to make an order of arrest of Mr. Arjun on the basis of notes of examination received from Mr. Vaibhav and to which authority, Mr. Ramanuj would have forwarded the copy of arrest order along with the document containing notes?

   (a) No, as such notes can't be considered as a material or evidence in his possession to be used against Mr. Arjun and Mr. Ramanuj would have forwarded the copy of arrest order along with the document containing notes to the Serious Fraud Investigation Office.

   (b) Yes, as such notes constitute valid evidence to be used against Mr. Arjun and Mr. Ramanuj would have forwarded the copy of arrest order along with the document containing notes to the Central Government.

   (c) No, as such notes can't be considered as a material or evidence in Mr. Ramanuj's possession to be used against Mr. Arjun and Mr. Ramanuj would have forwarded the copy of arrest order along with the document containing notes to NCLT.

   (d) Yes, as such notes constitute valid evidence to be used against Mr. Arjun and Mr. Ramanuj would have forwarded the copy of arrest order along with the document containing notes to the Serious Fraud Investigation Office.

5. What was the last date available with Tribunal to give response to the application made by Balfor Ltd. with respect to its employees as well as with Balfor Ltd. to file appeal with the appellate tribunal?

   (a) 10th November, 2020 and 26th November, 2020, respectively.

   (b) 9th November, 2020 and 25th November, 2020, respectively.

   (c) 10th November, 2020 and 25th December, 2020, respectively.

   (d) 9th November, 2020 and 26th November, 2020, respectively.

Case scenario 2

Shri Hari Textiles Limited was incorporated in the year 2010. Its Registered Office is situated in Connaught Place, New Delhi. It filed its audited annual financial statements for the financial year 2019-20 well within time with the jurisdictional Registrar of Companies. The Registrar inspected the statements and after reviewing them, felt the need to seek clarifications on certain matters. Accordingly, a written notice was sent by the Registrar to the company and its officials

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directing them to comply with the notice within thirty days of its receipt. However, the company and its officials failed to reply within the time specified in the notice.

The Registrar initiated the inquiry and proceeded further for inspecting all the documents of the company. While conducting the inquiry, the Registrar on prudent grounds believed that some of the documents and other vital information in relation to the company would be destroyed or altered by the official of the company. With a view to safeguard the documents, the Registrar obtained an order from the Special Court and thereafter, seized all such material.

While inspecting some of the documents the Registrar came to know that the Board of Directors had passed a resolution in a Board Meeting held on 10-04-2019 and thereby, increased the remuneration payable to the directors including two whole-time directors and Managing Director to 12% of the net profits of the company which was a sharp increase of 5% from the preceding financial year.

Prior to the inquiry, two directors of the company, namely, Mr. X and Mr. D got retired. The Registrar found from the inspection of the documents that they were involved in certain dealings which included selling of the assets of the company. On the basis of such information gathered from the inspected documents, the Registrar sought some clarifications from both of them regarding the dubious transactions. However, both Mr. X and Mr. D refused to appear before him showing their non-availability in the town and also represented through a common representative that they were no more a part of the Board of Directors of Shri Hari Textiles Limited.

After the completion of inspection and inquiry, the Registrar submitted a written report to the Central Government in respect of his findings against the company. The reports mentioned that there were major discrepancies in the assets and liabilities as well as profit and loss statements filed by the company.

On receipt of report from the Registrar, the Central Government considered it necessary to investigate the affairs of the company by the Serious Fraud Investigation Office (SFIO). Accordingly, by an order SFIO was directed to conduct the investigation of Shri Hari Textiles Limited and submit its report within the stipulated time. As instructed by the Central Government, SFIO authorised some of its inspectors to investigate the affairs of the company. The team deputed by the SFIO included experts in the field of cost accounting, financial accounting, taxation, law and forensic auditing.

While inspecting the company, the team of SFIO came to know that the Income-tax authorities had already initiated investigation against Shri Hari Textiles Limited.

Multiple Choice Questions (MCQs) [2 Marks each]

6. Shri Hari Textiles Limited and its officials failed to submit any reply to the written notice issued by the Registrar within the time specified in the notice. How much fine can be imposed for such failure?

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(a) The Company and every defaulting officer shall be punishable with a fine up to ₹ 1,00,000 and in case of continuing failure, with an additional fine up to ₹ 500 for every day after the first during which the failure continues.

(b) The Company and every defaulting officer shall be punishable with a fine up to ₹ 1,50,000 and in case of continuing failure, with an additional fine up to ₹ 1,000 for every day after the first during which the failure continues.

(c) The Company and every defaulting officer shall be punishable with a fine up to ₹ 1,00,000 and in case of continuing failure, with an additional fine up to ₹ 5,000 for every day after the first during which the failure continues.

(d) The Company and every defaulting officer shall be punishable with a fine up to ₹ 2,00,000 and in case of continuing failure, with an additional fine up to ₹ 5,000 for every day after the first during which the failure continues.

7. From the case scenario, it is observed that the Registrar seized certain important documents in the course of inquiry. After inspection what procedure is to followed pertaining to such documents?

(a) The Registrar is required to submit such documents in the Special Court which permitted seizure.

(b) The Registrar is required to forward all such documents along with the inquiry report to the Central Government.

(c) The Registrar is required to return such documents back to the company after making, if considered necessary, the copies of them.

(d) The Registrar is required to retain such documents until further instruction is received from the Special Court.

8. What is the requisite requirement for increasing the remuneration of directors including whole-time directors and Managing Director to 12% so that it shall be in accordance with the relevant provisions of the Companies, Act, 2013?

(a) Board Resolution increasing the remuneration to 12% needs to be authorised at the General Meeting and thereafter, duly sanctioned by the ROC.

(b) Board Resolution increasing the remuneration to 12% needs to be authorised at the General Meeting and thereafter, duly sanctioned by the Tribunal.

(c) Board Resolution increasing the remuneration to 12% needs to be authorised at the General Meeting subject to Schedule V.

(d) Board Resolution increasing the remuneration to 12% needs to be authorised at the General Meeting and thereafter, duly sanctioned by the Central Government through Regional Director.

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9. The case scenario states that the Registrar of Companies had called ex-directors of the company for examining them during the inquiry. Is the Registrar empowered to call the ex-directors:
   (a) The Registrar cannot call ex-directors of the company, without the order of the court.
   (b) The Registrar may, by issuing a written notice, call the ex-directors for seeking the requisite information.
   (c) In case the Registrar is appointed by the Central Government to conduct investigation, then only he can call ex-directors of the company.
   (d) Except the Tribunal, no other authority is empowered to call ex-directors of a company for any examination.

10. According to the case scenario, while inspecting the company, the team of SFIO came to know that the Income-tax authorities had already initiated investigation against the company. From the given options, choose the correct one that indicates as to how in amidst of such a situation, SFIO will be continuing with the investigation.
   (a) SFIO has to put its investigation on hold so long as the company is being investigated by Income-tax authorities.
   (b) SFIO will proceed with its investigation on the basis of report submitted by Income-tax authorities.
   (c) SFIO will proceed with its investigation while Income-tax authorities shall keep on hold its investigation.
   (d) SFIO will simultaneously continue its investigation along with the Income-tax authorities.

INDEPENDENT MCQS [Question 11-22]

11. ABC Ltd incorporated in India want to register as an ARC to commence the business of asset reconstruction. The company made all the arrangement required for the realisation of the financial assets acquired for the purpose of reconstruction of the assets and shall be able to pay periodical returns on respective due dates on the investments made in the company. The directors are well qualified and had nearly 25 years of experience in finance, 10 years of experience in reconstruction and securitisation of assets. The company has also complied with all the requirement of regulations and guidelines issued by Reserve Bank of India. The details of the profits made during the past 3 years are 2016-17 ₹ 200 Cr (Loss), 2017-2018 ₹ 500 Cr (Profit), 2018-2019 ₹ 700Cr. (Profit).
   (a) The ARC can be registered and certificate be issued by RBI, but RBI may not prescribe any further conditions.
   (b) The ARC can be registered and certificate be issued by RBI, but RBI may prescribe any further conditions.
   (c) The ARC registration cannot be made.

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(d) RBI has no power to register ARC, as ARC's are governed by SARFAESI Act, 2002.

12. Proceedings under the Prevention of Money Laundering Act, 2002 were initiated against Mr. Suraj. Through an order, property of Mr. Suraj has been attached under section 8. Mr. Suraj Preferred an appeal to the Appellate Tribunal. Mr. Suraj is adjudicated an insolvent during the pendency of the appeal. What will happen to the proceedings initiated under PMLA in the given case?

    (a) Proceedings will be dispensed with

    (b) His legal representatives will continue proceedings before the Appellate Tribunal

    (c) The official assignee or the official receiver, as the case may be, continue the appeal before the Appellate Tribunal.

    (d) Creditors will continue the proceedings before the Appellate Tribunal

13. Who shall determine the amount of claim due to a creditor under the Insolvency and Bankruptcy Code during the Corporate Insolvency Resolution Process (CIRP)?

    (a) Committee of creditors

    (b) Resolution professional

    (c) Adjudicating Authority

    (d) Corporate debtor

14. Can an Adjudicating Authority order the liquidation of a corporate debtor even after approving the resolution plan:

    (a) Yes, if the resolution plan is contravened.

    (b) The Adjudicating Authority may order the liquidation of a corporate debtor even after approving the resolution plan on receiving an application from a third party who is unaffected by such liquidation

    (c) Yes, the Adjudicating Authority may order for the liquidation of a corporate debtor if the committee of creditor does not approve the resolution plan after its approval by the Adjudicating Authority

    (d) No, the Adjudicating Authority cannot order the liquidation of a corporate debtor after approving the resolution plan.

15. What is the periodicity of submission of report by company liquidator with respect to the progress of winding up of the company to the Tribunal:

    (a) Monthly

    (b) Bi-monthly

    (c) Quarterly

    (d) Half yearly

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16. Mr. X, a resident of India planned a tour of 15 days to visit Paris and to meet his niece living there. While returning to India, Mr. X was carrying with him INR 30,000. Her niece told him that limit is marked on bringing Indian currency notes at the time of return to India. Identify the correct limit :

    (a) INR 2000

    (b) INR 5000

    (c) INR 10,000

    (d) INR 25,000

17. In the case of financing of a financial asset by more than one secured creditors, there secured creditor shall be entitled to exercise any of the rights conferred on him is agreed upon by the secured creditors representing ---------in order to make such an action binding on all the secured creditors.

    (a) Less 60% in value of the amount outstanding as on a record date

    (b) Not less than 60% in value of the amount outstanding as on a record date

    (c) At least 75% in value of the amount outstanding as on a record date

    (d) Not less than 75% in value of the amount outstanding as on a record date

Descriptive Questions [Questions 18- 26]

18. Dharma Ltd. in the light of prospective developments in the infrastructure of company decided to have borrowing on long term basis from financial Institutions. In the Board Meeting held on 15th September, 2020, following proposal of borrowing 2,00,00,000 from Financial institutions on long-term basis was also presented for consideration. As per the given information, in the light of relevant provisions of the Companies Act, 2013, examine the eligibility of the amount up to which the Board can borrow from Financial institution and the state on the validity of the said proposal.

    Following were the Balance Sheets of last three years of Dharma Ltd., containing following facts and figure of financial information :

Particulars	As at 31.03.2018 ₹	As at 31.03.2019 ₹	As at 31.03.2020 ₹
Paid up capital	60,00,000	60,00,000	85,00,000
General Reserve	50,00,000	52,50,000	60,00,000
Credit Balance in Profit & Loss Account	6,00,000	8,50,000	20,00,000
Securities Premium	3,00,000	3,00,000	3,00,000
Secured Loans	20,00,000	25,00,000	40,00,000

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19. Mr. Shariff who was a Key Managerial Personnel (Manager) of XYZ Ltd. retired on 12th May 2020. An examination of the final accounts of the company for the year ended on 31st March 2020, the Registrar of Companies found some serious irregularities in writing off of the huge amounts of bad debts and no satisfactory explanation was provided for the same from the company. In such a situation the Registrar of Companies wants some explanation from the company and Mr. Shariff. In the light of the Companies Act, 2013, examine the situation and advice on the act of Registrar seeking explanation from Mr. Shariff.

20. Mr. M, a member of XYZ Ltd. filed an application before the Tribunal complaining of oppression and mismanagement w.r.t. an agreement entered by XYZ Ltd. effecting the interest of the company. Vide order passed by the Tribunal under section 242 of the Companies Act, 2013, terminated the said agreement. The agreement was entered by Mr. H and Mr. G who was managing director and the executive director of the XYZ Ltd. Mr. Rasik, with whom the XYZ Ltd entered the agreement, filed a petition claiming the loss caused due to termination of the said agreement. Also state the legal position of Mr. H and Mr. G holding their place of office in the said situation. Examine the given facts and address the issues in terms of the relevant provisions of Companies Act, 2013.

21. Mr. Ingenious, who is registered as an Intermediary fails to enter into an agreement with his client and hence penalised by SEBI under the SEBI Act 1992. Advise Mr. Ingenious as to what remedies are available to him against the order of SEBI.

22. A foreign tourist comes to India and he purchases a antiques from a shop. He would like to pay US$ 30 in cash to the shopkeeper. Comment in the light of the FEMA, whether shopkeeper is permitted to accept foreign currency?

23. Comment upon nature of offence committed under the Prevention of Money Laundering Act? In the case, a spouse sold their property in 175 lakh to Mr. Y. In lieu of the sale, they obtained amount 100 lakh through RTGS in his account and rest amount of 75 lakh in cash which he transferred to wife's offshore bank account . Examine the liability of the spouse in the given case in the light of the PMLA, 2002. Also state whether they will be liable to be released on bail.

24. X, is an association having registration to transfer the Foreign Contribution received by it to another organization? Is this the valid act of X? If yes, then what is the process to do so? Is there any restriction on transfer of funds to other organizations?

25. Anil, who is a Chartered Accountant with his own independent practice, is the arbitrator in an arbitration between Tata Tea Inc., and Suzuki Ltd.

    scenarios **I** - Prior to starting his practice, Anil had worked for five years with Tata Tea Inc.

    II – During the proceedings before the arbitral tribunal, Anil would allow Tata Tea to take many liberties, for instance taking as much time for making oral arguments, cross examining the witnesses, for submitting documents, etc. Also the proceedings were adjourned (postponed) whenever so requested by Tata Tea. When Suzuki Motors wanted

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to take extra time they were not allowed. In few instances when they were permitted, they are asked to pay heavy cost to Tata Tea for delaying the proceedings..

Suziki Ltd. on the basis of above scenarios wanted to challenge the appointment of Mr. Anil. State whether the appointment of Mr. Anil as an arbitrator can be challenged?

26. X Inc Ltd is a holding company of Y Infrastructure Ltd. Insolvency resolution process was initiated against the X Inc Ltd on 15th December 2020. In the mean time another financial creditor initiated corporate insolvency resolution process against Y Infrastructure Ltd. Later X Inc Ltd filed an appeal contending that resolution process against Y Infrastructure Ltd. should not continue till corporate insolvency resolution process is decided in the case of X Inc Ltd. on the basis of initiation of moratorium. Also the Resolution plan of X Inc Ltd. approved by CoC, was still pending before the Adjudicating authority for its approval. In the light of given situation, examine whether corporate insolvency resolution process initiated against the X Inc Ltd., can bar the corporate insolvency resolution process initiated against the Y Infrastructure Ltd.?

SUGGESTED ANSWER

DIVISION A: CASE SCENARIO BASED MCQS/ INDEPENDENT MULTIPLE CHOICE QUESTIONS

Answers Keys to MCQs

Question No.	Answer
1.	(a)
2.	(c)
3.	(c)
4.	(d)
5.	(b)
6.	(a)
7.	(c)
8.	(c)
9.	(b)
10.	(c)
11.	(c)
12.	(c)
13.	(b)
14.	(a)

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15.	**(c)**
16.	**(d)**
17.	**(b)**

DIV B: Descriptive Questions [Questions 18- 26]

18. **Borrowing from Financial Institutions:** As per Section 180(1)(c) of the Companies Act, 2013, the Board of Directors of a company, without obtaining the approval of shareholders in a general meeting, can borrow money including moneys already borrowed up to an amount which does not exceed the aggregate of paid up capital of the company, free reserves and securities premium. Such borrowing shall not include temporary loans obtained from the company's bankers in the ordinary course of business. Here, free reserves do not include the reserves set apart for specific purpose.

Since the decision to borrow is taken in a meeting held on 15th September, 2020, the figures relevant for this purpose are the figures as per the Balance Sheet as at 31.03.2020. According to the above provisions, the eligibility of Board of Directors of Dharma Ltd.to borrow up to an amount is calculated as follows:

Particulars	₹
Paid up Capital	85,00,000
General Reserve (being free reserve)	60,00,000
Credit Balance in Profit & Loss Account (to be treated as free reserve)	20,00,000
Securities Premium	3,00,000
Aggregate of paid-up capital, free reserves and securities premium	1,68,00,000
Total borrowing power of the Board of Directors of the company, i.e, 100% of the aggregate of paid-up capital, free reserves and securities premium	1,68,00,000
Less: Amount already borrowed as secured loans	40,00,000
Amount up to which the Board of Directors can further borrow	1,28,00,000

Dharma Ltd. is entitled to borrow ₹1,28,00,000 through board of directors. As in the given case proposal of borrowing was Rs, 2,00, 00, 000 which is more than eligibility to borrow, therefore, Dharma Ltd, have to seek approval of shareholders in general meeting. As the proposal of borrowing ₹ 2,00,00,000 from Financial institutions on long-term basis was presented for consideration in Board Meeting without approval of shareholders in general meeting, therefore said proposal is invalid.

19. As per the provisions of Section 206(2) of the Companies Act, 2013, the Registrar can call for any information or explanation or any other further documents related to the company from the company or any officer if the company, which he thinks, is necessary for deciding

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any matter of the company. Proviso to Section 206(2) provides that, where such information or explanation relates to any past period, the officers who had been in the employment of the company for such period, if so called upon by the Registrar through a notice served on him, in writing, shall also furnish such information or explanation to the best of their knowledge. So, in the given case Mr. Shariff, the ex-manager of the company can be called upon for such information/explanation which was related to their period of service.

20. As per section 243 of the Companies Act, 2013 , where an order made under section 242 terminates, sets aside or modifies an agreement which was entered by the company, were in a manner prejudicial to the interests of the company,—

(a) such order shall not give rise to any claims whatever against the company by any person for damages or for compensation for loss of office or in any other respect either in pursuance of the agreement or otherwise;

(b) no managing director or other director or manager whose agreement is so terminated or set aside shall, for a period of five years from the date of the order terminating or setting aside the agreement, without the leave of the Tribunal, be appointed, or act, as the managing director or other director or manager of the company:

Accordingly, Mr. Rasik, with whom the XYZ Ltd entered the agreement, filed a petition claiming the loss caused due to termination of the said agreement, is not viable. Further, Mr. H and Mr. G, managing director and the executive director of the XYZ Ltd. who entered agreement with Mr. Rasik which was ordered to be terminated by the Tribunal, shall not act as the managing director or other director or manager of the company, for a period of five years from the date of the order terminating or setting aside the agreement, without the leave of the Tribunal.

21. **Remedies against SEBI order:** Section 15B of the Securities and Exchange Board of India Act, 1992 lays down that if any person, who is registered as an intermediary and is required under this Act or any rules or regulations made there under, to enter into an agreement with his client, fails to enter into such agreement, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less. Mr. Ingenious has been penalised under the above mentioned provision. Two remedies are available to Mr. Ingenious in this matter:-

(i) **Appeal to the Securities Appellate Tribunal:** Section 15T of the SEBI Act, 1992 states that any person aggrieved,—

(a) by an order of the Board made, on and after the commencement of the Securities Laws (Second Amendment) Act, 1999, under this Act, or the rules or regulations made thereunder; or

(b) by an order made by an adjudicating officer under this Act; or

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(c) by an order of the Insurance Regulatory and Development Authority or the Pension Fund Regulatory and Development Authority, may prefer an appeal to a Securities Appellate Tribunal having jurisdiction in the matter.

Every appeal shall be filed within a period of forty-five days from the date on which a copy of the order made by the Board or the Adjudicating Officer or the Insurance Regulatory and Development Authority or the Pension Fund Regulatory and Development Authority, as the case may be, is received by him and it shall be in such form and be accompanied by such fee as may be prescribed :

Provided that the Securities Appellate Tribunal may entertain an appeal after the expiry of the said period of forty-five days if it is satisfied that there was sufficient cause for not filing it within that period.

On receipt of an appeal under sub-section (1), the Securities Appellate Tribunal may, after giving the parties to the appeal, an opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or setting aside the order appealed against.

The Securities Appellate Tribunal shall send a copy of every order made by it to the Board, or the Insurance Regulatory and Development Authority or the Pension Fund Regulatory and Development Authority, as the case may be the parties to the appeal and to the concerned Adjudicating Officer.

The appeal filed before the Securities Appellate Tribunal under sub-section (1) shall be dealt with by it as expeditiously as possible and endeavor shall be made by it to dispose of the appeal finally within six months from the date of receipt of the appeal.

(ii) **Appeal to the Supreme Court:** Section 15Z of the SEBI Act, 1992 provides that any person aggrieved by any decision or order of the Securities Appellate Tribunal may file an appeal to the Supreme Court within 60 days from the date of communication of the decision or order to him on any question of fact or law arising out of such order. The Supreme Court may, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding 60 days.

22. As per section 3 of the FEMA, save as otherwise provided in this Act, rules or regulations made thereunder, or with the general or special permission of the Reserve Bank, no person shall receive otherwise than through an authorised person, any payment by order or on behalf of any person resident outside India in any manner.

Where any person in, or resident in, India receives any payment by order or on behalf of any person resident outside India through any other person (including an authorised person) without a corresponding inward remittance from any place outside India, then, such person shall be deemed to have received such payment otherwise than through an authorised person;

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Here in the given case, the foreign tourist wanted to pay foreign currency in cash on purchase of antiques to shopkeeper which as per section 3, is not permissible to any person to receive any payment by order or on behalf of any person resident outside India in any manner except received through an authorised person. Therefore, the Shopkeeper cannot accept cash as it will be a receipt otherwise than through Authorised Person except where the shopkeeper have taken a money changers license to accept foreign currency.

23. **Nature of offence committed under the Act:** Section 45 of the PMLA, 2002, provides that the offences under the Act shall be cognizable and non-bailable. Person accused of an offence under this Act shall not be released on bail or on his own bond unless-

(i) The Public Prosecutor has been given an opportunity to oppose the application for such release and

(ii) Where the Public Prosecutor opposes the application, the court is satisfied that there are reasonable grounds for believing that he is not guilty of such offence and that he is not likely to commit any offence while on bail.

Exceptions: In case of any person who is under the age of 16 years or in case of a woman or in case of a sick or infirm or is accused either on his own or along with other co-accused of money-laundering a sum of less than one crore rupees, may be released on bail, if the Special Court so directs.

As per the said section the spouse, are liable for commission of an offence of money laundering by transferring an unaccounted money obtained through sale of their property to an offshore bank account of his wife with an intent to evade tax. As the husband and his wife, i.e., the spouse jointly acted in the commission of the act of money-laundering of a sum less than one crore rupees (75 lakh which was paid in cash), so the wife may be released on bail, if the Special Court so directs. Whereas the Husband shall be released on bail/on his own bond only on compliance with above stated provision.

24. Yes, X can transfer the Foreign Contribution received by it to another organization as per section 7 of FCRA, 2010. According to the provision no person who –

- is registered and granted a certificate or
- has obtained prior permission under this Act; and
- receives any foreign contribution,

shall transfer such foreign contribution to any other person unless such other person is also registered and had been granted the certificate or obtained the prior permission under this Act:

Provided that such person may transfer, with the prior approval of the Central Government, a part of such foreign contribution to any other person who has not been granted a certificate or obtained permission under this Act in accordance with the rules made by the Central Government."

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Restrictions on transfer: Rule 24 of FCRR, 2011, prescribes the procedure for transferring foreign contribution to any unregistered person as under:

(1) A person who has been granted a certificate of registration or prior permission under section 11 and intends to transfer part of the foreign contribution received by him to a person who has not been granted a certificate of registration or prior permission under the Act, may transfer such foreign contribution to an extent not exceeding ten per cent of the total value thereof and for this purpose, make an application to the Central Government in the prescribed Form.

(2) Every application made above shall be accompanied by a declaration to the effect that-

(a) the amount proposed to be transferred during the financial year is less than ten per cent of the total value of the foreign contribution received by him during the financial year;

(b) the transferor shall not transfer any amount of foreign contribution until the Central Government approves such transfer.

(3) A person who has been granted a certificate of registration or prior permission under section 11 shall not be required to seek the prior approval of the Central Government for transferring the foreign contribution received by him to another person who has been granted a certificate of registration or prior permission under the Act provided that the recipient has not been proceeded against under any of the provisions of the Act.

(4) Both the transferor and the recipient shall be responsible for ensuring proper utilisation of the foreign contribution so transferred and such transfer of foreign contribution shall be reflected in the returns in Form to be submitted by both the transferor and the recipient."

25. As per section 12 of the Arbitration and Conciliation Act, 1996, when a person is approached in connection with his possible appointment as an arbitrator, he shall disclose in writing any circumstances-

a. such as existence either direct or indirect of any past or present relationship with or interest in any of the parties or in relation to the subject matter in dispute, whether financial, business, professional or other kind, which is likely to give rise to justifiable doubts as to his independence or impartiality; and

b. which are likely to affect his ability to devote sufficient time to the arbitration and in particular his ability to complete the entire arbitration within a period of twelve months.

In the first case Anil had worked for five years with Tata Tea Inc. In this situation the law would deem Anil to be lacking independence.

In second case, arbitrator by his / her behaviour gives an impression that he is favouring one party over the other.

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An arbitrator may be challenged only if circumstances exist that give rise to justifiable doubts as to his independence or impartiality. In the given scenarios, it would be deemed that Anil to be lacking independence and whereas in the second case it clearly reflects that arbitral tribunal favours and is partial towards Tata Tea, and therefore lacks impartiality. Yes, appointment of Mr. Anil as an arbitrator can be challenged.

26. In the given case, both the X Inc Ltd. and Y Infrastructure Ltd. in the eyes of law are separate entity. Further section 14 of IBC, 2016 which deals with moratorium, no where prohibits initiation of corporate insolvency resolution process on the subsidiary company or its holding company. Further also that a separate CIRP has been initiated against another corporate debtor by another financial creditor, which is altogether separate and have no connection with the CIRP initiated against X Inc Ltd. or Y Infrastructure Ltd.

Therefore, in the given case, corporate insolvency resolution process initiated against the X Inc Ltd, which is a holding company, cannot bar the corporate insolvency resolution process initiated against the Y Infrastructure Ltd which is its subsidiary or vice versa.

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