

**SUGGESTED ANSWERS
TO
QUESTIONS**

(SYLLABUS - 2008)

**SET AT THE
FINAL EXAMINATION**

DECEMBER 2010

GROUP III



**THE INSTITUTE OF
COST AND WORKS ACCOUNTANTS OF INDIA**

12, SUDDER STREET, KOLKATA-700 016

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GUIDELINES TO STUDENTS

1. Students are advised to consult Study Notes and Text Books supplemented by the Suggested Answers.
2. Working Notes should be a part of Answers, particularly in Capital Market Analysis & Corporate laws, Financial Management and International Finance.
3. Assumptions should be logical and clearly stated in the Answers.

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FINAL EXAMINATION - GROUP III (SYLLABUS - 2008)

SUGGESTED ANSWERS TO QUESTIONS

DECEMBER -2010

PAPER – F-P11 : CAPITAL MARKET ANALYSIS & CORPORATE LAWS

Section I (60 Marks)

(CAPITAL MARKET ANALYSIS)

Answer Question No. 1 which is compulsory and any two from the rest in this section.

Question:

1.(a) In each of the cases given below one out of four is correct. Indicate the correct answer (=1 mark) and give your working/reasons briefly (= 1 mark):

(i) The following securities are available in the market for investment:

Security	Return (%)	Standard Deviation (%)
Gift-edged security	6	0
Equity of ROLT LTD	20	20

If MR VARDHAN is planning to invest Rs. 5,00,000 to construct a portfolio with standard deviation of 18%, the return on such portfolio will be:

- A. Rs. 72,000
- B. Rs. 93,000
- C. Rs. 95,000
- D. None of the above

- (ii) In September, 2010, a six-month call on MELANIN LTD's stock with an exercise price of Rs. 30 sold for Rs.6. The stock price was Rs. 25, the risk free interest was 5% per annum. How much would you be willing to pay for a six-month put on Melanin Ltd's stock with same maturity and exercise price?

[Given: $e^{0.05 \times 0.5} = 0.9753$]

- A. Rs. 7.41
 B. Rs. 9.52
 C. Rs. 10.26
 D. Insufficient information
- (iii) ANISHA LTD issues rights shares which increases the market value of the shares of the company by Rs. 200 crore. The aggregate market value of all shares included in the index before the rights issue made was Rs. 4000 crore. If the base year average for calculating the index number for a period starting from the time of right issue is made till the next base year change becomes necessary is Rs. 2000 crore, what is the existing base year average?
- A. Rs. 2011.88
 B. Rs.1904.76
 C. Rs. 1897.76
 D. Incomplete information
- (iv) MR. KHUBERAN wants to purchase a stock that has a beta coefficient of 0.75. He estimates the expected market return to be 0.12 while T-Bills yield 0.09. What rate should he expect and require on the stock according to the SML (Security Market Line):
- A. 0.11
 B. 0.12
 C. 0.13
 D. None of the above

2x4=8

(b) Choose the most appropriate answer from the stated options and write it down.

(Only indicate A, B, C or D as you think correct)

- (i) Which of the following would be true evidence against the semi-strong form of market efficient theory?
- A. Trend analysis is worthless in determining stock prices
 B. Positive abnormal returns can be expected from low P/E stock
 C. Mutual fund managers do not persistently make superior returns
 D. Investor cannot make superior profits by changing his portfolio according to change in interest returns
- (ii) At the beginning of a trading day, MS SONIA is in a short position in the futures market and her collateral is exactly at the required margin. If the closing futures price is below the opening price, what will happen at the end of the day?
- A. She will be subject to a margin call
 B. Her losses will be carried forward to the next day
 C. Her account will be marked to market and gains will be transferred in the account
 D. None of the above

- (iii) When an existing listed company either makes a fresh issue of securities to the public or makes and offer for the sale of securities to the public for the first time such issues are called:
- A. Initial public offering
 B. Follow on public offering
 C. Green shoe option
 D. None of the above
- (iv) Book building process is different from fixed price process for raising share capital from the public. Which of the following statements is /are true about book-building process?
- A. Price at which securities will be offered/ allotted is not known in advance to investors. Only an indicative price is known
 B. Demand for the securities offered can be known everyday
 C. Payment is made at the time of subscription
 D. Both A and B above 1x4=4

(c) Fill in the blanks with appropriate answers:

- (i) Beating the market by analyzing data obtained from magazines, reports and newspapers means that the market are in _____ form.
- (ii) The PSU (Public sector undertaking) bonds are securities as defined under _____ Act.
- (iii) In case of a new ULIP, IRDA has permitted partial withdrawal by a client only after _____ Years.
- (iv) The fringe market is _____ (a disorganized/also and organized but informal) money market, deemed to include everything that is outside the scope of the money market.
- (v) The conditions that must be satisfied before an entity is licensed to carry out the activities of a collective investment management company are Adequate Management Structure and _____
- (vi) The expansion of OTCEI is _____.
- (vii) For liquid securities the VaR margins are based on the _____ of the security.
- (viii) By virtue of their structures, mutual fund schemes are classified as open-ended, cost-ended _____ schemes. 1x8

Answer to Question No. 1 (a):

(i) **B: Rs. 93000/-**

Variance of Portfolio: $O_p^2 = W_f^2 O_f^2 + W_r^2 O_r^2 + 2W_f O_f W_r O_r$

Prf, since Std deviation of Gilt-edged Securities is 0 and its correlation with equity is also 0 the above formula will reduce to

$$O_p^2 = W_r^2 O_r^2$$

$$\text{Therefore, } O_p = W_r O_r$$

$$\text{Or: } 18\% = 20\% W_r$$

$$\text{Hence, } W_r = 0.18/0.20 = 0.9 \text{ and } W_f = 1 - 0.9 = 0.1$$

$$\text{Return of Portfolio (Rp)} = W_f R_f + W_r R_r = 0.1 \times 6\% + 0.9 \times 20\% = 18.6\%$$

$$\text{Return (in Rupees)} = 0.186 \times 500000 = \text{Rs. } 93000/-$$

(ii) C: Rs.10.26

From Put – Call Parity theorem, We Know

$$P = C + PV \text{ of Exercise Price} - S. \text{ (Where P = Price of Six month put)}$$

$$= 6 + 30 \times 0.9753 - 25$$

$$= 35.26 - 25 = \text{Rs.10.26}$$

(iii) B: Rs. 1904.76 Crore

$$\text{New base year Average} = \text{Old base year Average} \times \frac{\text{New market value}}{\text{Old market value}}$$

$$\text{Or, } 2000 = \text{Old base year Average} \times$$

$$\text{Hence, Old base year Average} = (2000/1.05) = \text{Rs. 1904.76 Crore.}$$

(iv) A: 0.11

$$E(R) = 0.09 + 0.75(0.12 - 0.09) = 0.1125$$

Answer to Question No. 1 (b):

- (i) B
- (ii) C
- (iii) B
- (iv) D

Answer to Question No. 1 (c):

- (i) Semi-strong inefficiency
- (ii) Securities Contracts Regulation – SCR
- (iii) Three
- (iv) Disorganized
- (v) Financial Requirement / Financial Structure
- (vi) Over The Counter Exchange of India
- (vii) Volatility
- (viii) Interval

Question:

2(a) How is a stock market index created? What are the aspects such an index should capture? List 2 advantages of a stock market index. 1+2=5

(b) MS CHAITRA, an investor is evaluating the prospects of investing two stocks viz., SPARTAN LTD and GOLIATH LTD. She has estimated the returns associated with the market index based on the subjective probability approach.

Her estimates are as follows:

Economics Scenario	Probability	Returns associated with: (in %)		
		Spartan Ltd.	Goliath Ltd.	Market Index
Boom	0.36	22	28	19
Growth	0.28	18	16	16
Stagnation	0.17	14	15	12
Slump	0.19	8	10	4

The expected risk free real rate of return and the premium for inflation are 4% and 4.5% per annum respectively. Assume that CAPM holds good in the market.

You are required to:

- (i) Calculate the betas of Spartan Ltd Goliath Ltd and comment on the same.
- (ii) Calculate excess return provided by both companies.
- (iii) Calculate the proportion of systematic risk and unsystematic risk for both companies.
- (iv) Determine which stock the investor would suggest to invest if he is required to select only one stock. Justify. 6+2+4+3=15

Answer to Question No. 2 (a):**Stock Market Index**

A stock market index is created by selecting a group of stocks that are representative of the whole market or a specified sector or segment of the market. An index is calculated with reference to a base period and a base index value.

A stock market index should capture the behavior of the overall equity market. Returns obtained by distinctive portfolios in the country, will be indicated by the movement of the index. An index is used to give information about the price movements of products in the financial, commodities or any other markets stockmarket indexes are useful for a variety of reasons, some of them are:

- It is lead indicator of the performance of overall economy or a sector of the economy,
- Stock indexes reflect highly up to date information,
- They provide a historical comparison of returns on money invested in the stock market against other forms of investment such as gold or debt,
- They can be used as a standard against which to compare the performance of an equity fund,
- Modern financial applications such as index Funds, Index Futures, Index Options Play an important role in financial investments and risk management.

Answer to Question No. 2 (b):

(i) Expected return of Spartan Ltd Stock:

$$RSL = 22 \times 0.36 + 18 \times 0.28 + 14 \times 0.17 + 8 \times 0.19 = 16.86\%$$

$$\sigma^2 SL = 0.36(22-16.86)^2 + 0.28(18-16.86)^2 + 0.17(14-16.86)^2 + 0.19(8-16.86)^2$$

$$\text{(Variance)} = 9.51 + 0.36 + 1.39 + 14.91 = 26.17\%$$

$$\sigma SL = \sqrt{26.17} = 5.12\%$$

(SD) Expected return of Goliath Ltd Stock:

$$RGL = 28 \times 0.36 + 16 \times 0.28 + 15 \times 0.17 + 10 \times 0.19 = 19.01\%$$

$$\sigma^2 GL = 0.36(28-19.01)^2 + 0.28(16-19.01)^2 + 0.17(15-19.01)^2 + 0.19(10-19.01)^2$$

$$\text{(Variance)} = 29.10 + 2.54 + 2.73 + 15.42 = 49.79\%$$

$$\sigma GL = \sqrt{49.79} = 7.06\%$$

(SD)

MARKET

Expected Return and Variance on MARKET:

$$E(RM) = 19 \times 0.36 + 16 \times 0.28 + 12 \times 0.17 + 4 \times 0.19 = 14.12\%$$

$$\sigma^2m = 0.36(19-14.12)^2 + 0.28(16-14.12)^2 + 0.17(12-14.12)^2 + 0.19(4-14.12)^2$$

$$(Variance) = 8.57 + 0.99 + 0.76 + 19.46 = 29.78\%$$

$$\sigma_m = \sqrt{29.78} = 5.46$$

Covariance (Spartan, Market):

$$\begin{aligned} \text{Cov}(GL, m) &= 0.36(22-16.86)(19-14.12) + 0.28(18-16.86)(16-14.12) \\ &\quad + 0.17(14-16.86)(12-14.12) + 0.19(8-16.86)(4-14.12) \\ &= 9.03 + 0.60 + 1.03 + 17.04 = 27.70\% \end{aligned}$$

Co-variance (Goliath, Market):

$$\begin{aligned} \text{Cov}(GL, m) &= 0.36(28-19.01)(19-14.12) + 0.28(16-19.01)(16-14.12) \\ &\quad + 0.17(15-19.01)(12-14.12) + 0.19(10-19.01)(4-14.12) \\ &= 15.79 - 1.58 + 1.45 + 17.32 = 32.98\% \end{aligned}$$

Beta of Spartan Ltd:

$$BSL = \frac{\text{COV}(GL, m)}{\sigma^2m} = \frac{27.70}{29.78} = 0.93$$

$$\sigma^2m \quad 29.78$$

Beta of Goliath Ltd

$$BGL = \frac{\text{Cov}(GL, m)}{\sigma^2m} = \frac{32.98}{29.78} = 1.11$$

$$\sigma^2m \quad 29.78$$

Thus betas of both the Stock states that, stock of SL is a defensive stock whereas stock of GL is an aggressive stock.

(ii) Required rate of Return = $R_f + \beta(R_m - R_f)$:

$$\text{Spartan Ltd} = 8.5 + 0.93(14.12 - 8.5) = 13.73\% \text{ (Where } R_f = \text{Inflation adjusted nominal}$$

$$\text{Excess return} = 16.86 - 13.73 = 3.13\%$$

$$\text{risk-free rate} = 4 + 4.5 = 8.5\%$$

$$\text{Goliath Ltd} = 8.5 + 1.11(14.2 - 8.5) = 14.74\%$$

$$\text{Excess Return} = 19.01 - 14.74 = 4.27\%$$

(iii) Spartan LTD

$$\text{Systematic Risk} = \sigma^2m \beta^2 SL = 29.78 \times 0.93^2 = 25.76\%$$

$$\text{Unsystematic Risk} = 26.17 - 25.76 = 0.14\%$$

$$\text{Porportion of Systematic Risk} = \frac{25.76}{26.17} \times 100 = 98.43\%$$

$$\text{Porportion of Unsystematic Risk} = 1 - 0.9843 = 0.0157 \text{ i.e. } 1.57\%$$

Goliath LTD.

$$\text{Systematic Risk} = \sigma^2m \beta^2 GL = 29.78 \times 1.11^2 = 36.69\%$$

$$\text{Unsystematic Risk} = 49.79 - 36.69 = 13.10\%$$

2

$$\text{Proportion of Systematic Risk} = (36.69 / 49.79) \times 100 = 73.69\%$$

$$\text{Proportion of Unsystematic Risk} = (13.10 / 49.79) \times 100 = 26.31\%$$

(iv) Excess Return / Standard Deviation:

$$\text{SPARTAN LTD} : 3.13 / 5.12 = 0.611$$

$$\text{GOLIATH LTD} : 4.27 / 7.06 = 0.605$$

As the excess return to standard deviation is higher for the stock of SPARTAN LTD, the investor should choose this stock (Spartan Ltd Stock):

Question:

3. (a) What do you mean by "Market impact cost"? 3
- (b) What is meant by Green/Shoe Option? Briefly discuss the same. 4
- (c) The expected market return for the general market is 13.5% and the risk premium is 7.5%. DEF Ltd. GHI Ltd and JKL Ltd have betas of 0.7, 0.84 and 1.1 respectively. What are the appropriate required rates of return for these securities? 4
- (d) The following quotes were observed by MR SAXENA on September 10, 2010 in the Economic Times:

Contracts	Open	High	Low	Close	Open Interest	Traded Quantity	No. of Contracts	Under lying
CE-2145-Sept 2010	210.15	222.5	210.15	225.39	45100	1600	8	NIFTY
PE-2310-Sept 2010	21.45	28.6	20.51	21.89	2911700	1369000	6845	NIFTY

Explain what these quotes indicate 2 + 3

- (e) Two funds are available for investment. Fund A is being launched today i.e. 31.12.2010 and available for investment at Rs. 10 per unit. A similar Fund-MX (same risk profile like Fund-A) is also available for investment at Rs. 19.45 per unit. The information of quarterly NAV for the next three quarters are available as given below. Investor Mr. ASHITAVA prefers Fund- A and Investor MS SONTAI prefers Fund-MX for investment through SIP (Systematic Investment Plan) each installment entailing Rs. 2000 for four quarters including initial investment:

Closing NAV	FUND-A (In Rs.)	FUND-MX (RS.)
31.12.2010	10.00	19.45
31.03.2011	11.1567	21.50
30.06.2011	14.7680	27.15
30.09.2011	12.8554	23.69

Required:

Which investor (Mr. Ashitava or Ms Sontai) would clock a higher return on investment as on 30.09.2011? (Ignore time value of money). 2+2

Answer to Question No. 3 (a):**Market impact cost**

Market impact cost is the best measure of the liquidity of a stock. It accurately reflects the costs faced when actually trading an index. Supposing a stock traders at bid 99 and ask 101. We say the 'ideal' price is Rs. 100. Now, supposing, a buy order for 1000 shares goes through at Rs. 102. Then it can be said that the market impact cost at 1000 shares is 2. Like wise, if a buy order for 2000 shares goes through at Rs. 104, it is said that the market impact cost at 2000 share is 4%. For a Stock to qualify, for possible inclusion into the S&P CNX Nifty, it has to reliably have market impact cost or below 0.75% when doing S&P CNX Nifty trades of half a crore rupees.

Answer to Question No. 3 (b):**Green Shoe Option**

Green Shoe Option denote and option of allocating shares in excess of the shares included in the public issue. It is an option that allows the underwriting of an IPO to sell additional shares if the demand is high. It can be understood as an option that allows the underwriter for a new issue to buy and resell additional shares up to a certain per-determined quantity. Looking to the exceptional interest of investors in terms of over subscription of the issue, certain provisions are made to issue additional shares or bonds to underwriters for distribution. The issue authorizes for additional shares or bonds. In common parlance, it is retention of over subscription to a certain extent. It is a special feature of EURO issues. In the Indian context, green Shoe option has a limited connection. In the SEBI guidelines governing public issue, certain appropriate provisions for accepting over-subscription subject to a ceiling, Say 15% of the offer made to public is provided. In certain cases, the green shoe option can be even more than 15%. The Green shoe option facility would bring in price stability of initial public offering.

Answer to Question No. 3 (c):

If the expected the market return is 13.50 per cent and the risk premium is 7.50, The riskless rate of return is 6.00% (13.50%-7.50%).

Therefore,

$$\text{DEF Ltd.} = 6 + 7.5 \times 0.7 = 11.25\%$$

$$\text{GHI Ltd.} = 6 + 7.5 \times 0.84 = 12.30\%$$

$$\text{DEF Ltd.} = 6 + 7.5 \times 1.10 = 14.25\%$$

Answer to Question No. 3 (d):

The First One indicated European Call option of NIFTY with September 2010 expiry having a strike price of 2145 and quoting at 225.39 (Premium). The Premium opened a quote of 210.15, touched a high & low of 225.50 and 210.15 respectively, before closing at 225.39. The open interest was 45100, meaning the September 2010 options outstanding and yet to be exercised. The traded quantity indicates the total Nifty Index traded and the number of Contracts traded was 8. This shows that each Nifty is $(1600/8) = 200$.

The Second One indicated European put option of Nifty with September 2010 Expiry having a strike price of 2310 and quoting at 21.89 (Premium) opened with a quote of 21.45, touched a high and low of 28.60 and 21.51 respectively, before closing at 21.89. The open interest was 2911700, meaning the September 2010 options outstanding and yet to be exercised. The traded quantity indicates the total Nifty Index traded and the number of Contracts traded was 6845. This shows that each Nifty is $(1369000/6845) = 200$.

Answer to Question No. 3 (e):

Amount (Rs.)	FUND-A		FUND-MX	
Installment-2000	NAV	Units	NAV	Units
31.12.2010	10.0000	200.0000	19.45	102.8278
31.03.2011	11.1567	179.2645	21.50	93.0233
30.06.2011	14.7680	135.4280	27.15	73.6648
30.09.2011	12.8554	155.5766	23.69	84.4238
Total		670.2691		353.9397
Value Investment	670.2691 x 12.8554 = Rs. 8616.58		353.9397 x 23.69 = Rs. 8384.83	
		(8000.00)		(8000.00)
Return		616.58		384.83
Return	616.58/8000 = 7.71%		384.83/8000 = 4.81%	

MR. ASHITAVA has fetched a higher return from Fund-A

Question:

4. (a) Describe the grounds on which an ombudsman can reject complaints lodged with him, under the Banking Ombudsman Scheme 2006. Can an appeal be filed against such a rejection and if so to whom and within what time limit? 5
- (b) Under what circumstances can a company registered as a Collective Investment Management Company raise funds from the public? 4
- (c) From the information furnished below relating to Deep Freeze Containers Ltd you are required to arrive at the call option price by applying the Black- Schools option Pricing model:
Strike Price = Rs. 45;
Number of days remaining for expiration = 183 days;
Prevailing stock Price = Rs. 47;
Expected price volatility / standard deviation = 25%
Risk free rate = 10% 5
- (d) Based on the credit rating of the bonds, MS ANSITA has decided to apply the following discount rates for valuing bonds:

Credit Rating	Discount
AAA	364-day T-bill rate + 3% spread
AA	AAA + 2% Spread
A	AAA + 3% Spread

She is considering investing in a AA rated, Rs. 1000 face value bond currently trading at Rs. 1026.50. The bond has 5 years to maturity and carries coupon at 12% per annum payable annually. The next interest payment is due one year from today and the bond is redeemable at par. (Assume the 364-day, T-Bill rate to be 6%)

You are required to:

- (i) Calculate the intrinsic value of the bond for MS ANSITA;
- (ii) Calculate the current yield (CY) and the yield to maturity (YTM) of the bond. 3+3

Note: (1) Ignore floatation costs and transaction costs;

(2) Extracted from the table of PV:

Interest Rate	6%	8%	9%	11%	12%
PVIFA (5 years)	4.212	3.993	3.890	3.696	3.605
PVIF (5 years)	0.747	0.681	0.650	0.593	0.567

Answer to Question No. 4 (a):

The Reserve Bank of India (RBI) brought about crucial amendments to the Banking Ombudsman Scheme 2006 which will now enable aggrieved customers to not only appeal against any Ombudsman's decision but also to appeal in case of complaints being rejected. The appeal could be made to the deputy Governor's Office of RBI.

The Ombudsman however has the right to reject Complaints if they are; not on the grounds of complaint referred to in Clause 8; beyond the pecuniary Jurisdiction of Banking Ombudsman prescribed; frivolous, vexatious, malafide; without any sufficient cause; that it is not pursued the complainant with reasonable diligence; in the opinion of the Banking Ombudsman there is not loss or damage or inconvenience caused to the Complainants; or requiring Consideration of elaborate documentary and oral evidence and the proceedings before the Banking Ombudsman.

in case of a complaint being aggrieved by the award under clause – 12 or by rejection of a Complaint, he may exercise the option of an appeal within 30 days, the RBI said in its notification.

Answer to Question No. 4 (b):

- A registered Collective Investment Management Company is eligible to raise funds from the public by launching schemes.
- Such schemes have to be compulsory credit rated as well as appraised by an appraising agency.
- The schemes also have to be approved by the Trustee and contain disclosures, as provided in the Regulations, which would enable to investors to make informed decision.
- A copy of the office document of the Scheme had to be filed with SEBI and if no modifications are suggested by SEBI within 21 days from the date of filing, then the collective investment Management Company is entitled to issue the offer document to the public raising funds from them.

Answer to Question No. 4 (c):

Computation of Call option

Apply the Black – Scholes formula:

$$V_e = PS [Nd1] - PX/e^{(RF)(T)} [Nd2]$$

$$d1 = \ln [47 / 45] + [0.10 + 0.5 (0.25)^2] 0.5 / 0.25 = 0.6172$$

$$d2 = 0.6172 - 0.25 / 0.25 = 0.4404$$

From a normal distribution table;

$$N(0.6172) = 0.7315 \text{ and}$$

$$N(0.4404) = 0.6702,$$

$$\text{So, } C = 47 (0.7315) - 45 (e^{-0.10(0.5)}) (0.6702) = \text{Rs } 5.69$$

Answer to Question No. 4 (d):

CALCULATION OF THE VALUE OF BOND TO MS. ANSITA

(i) The Appropriate discount rate for valuating the bond for MS. ANITHA is :

$$= 6+3+2= 11\%$$

CASH FLOWS:

Yers	P.V Factor at 11%	Present Value (PV)
1-5 Dividend	3.696	443.52
5 Maturity Value Rs.1000	0.593	593.00
INTRINSIC BALUE PER BOND (PO)		<u>1063.52</u>

(ii) CALCULATION OF CURRENT YIELD (ye):

$$\frac{120}{1026.50} = 0.1169. \text{ i.e } 11.69\%$$

CALCULATION OF YTM:

Since, when discounted at 11% the value is Rs. 1036.52 (more than Rs. 1026.50), we try at 12% discount.

$$PO = 120 \times PVIFA (12\% 5 \text{ yrs}) + 1000 PVIF (12\%, 5 \text{ yrs})$$

$$= 120 \times 3.605 + 1000 \times 0.567 = \text{Rs. } 999.60$$

$$\text{As given. } P_0 = \text{Rs. } 1026.50$$

By Interpolation:

$$YTM = 11 + (12-11) \times \frac{1036.52-1026.50}{1036.52-999.60}$$

$$= 11 + 1 \times \frac{10.02}{36.92} = 11.27\%$$

$$\text{Yield to Maturity (YTM) = } \underline{11.27\%}$$

SECTION - II (40 Marks)
(Corporate Laws)

Answer Question No. 5 which is compulsory and any two from the rest, in this Section.

Question:

5. (a) Choose the most appropriate answer from the stated options and write it down (Only indicate A,B,C or D as you think correct).
- (i) ESCORT LTD has 12 directors on its Board. The maximum number of non-rotational Directors the Company can have on its Board is:
- A. 2
B. 3
C. 4
D. 5
- (ii) The office of the Director becomes vacant if he fails to obtain the share qualifications, if any required by the Articles:
- A. Within 2 months of appointment;
B. Within 1 month of appointment;
C. Within 1 year of appointment;
D. Before appointment.
- (iii) The concept of Corporate Governance was initiated on the recommendation of the report by:
- A. Confederation of Indian Industry (CII)
B. Dr. Y.V. Reddy;
C. Mr. Kumar Mangalam Birla;
D. Narayana Murthy.
- (iv) An application to investigate the affairs of a public Company where the shareholders are scattered all over the country can be made to the National Company Law Tribunal (NCLT) by
- A. Any one hundred members;
B. Any two hundred members;
C. Not less than one fifth of the persons on that Company's register of members;
D. Not less than one fourth of the persons on that Company's register of members;

1x4=4

(b) Fill in the blanks with appropriate answers;

- (i) Buy back of equity shares by an Indian company should not exceed _____ % of its paid up equity capital in the financial year.
- (ii) In the context of classification of risks, fraud will fall under _____.
- (iii) The membership of the Governance and nominating Committee consists of at least _____ each of whom shall meet the independent requirements established by the Board.
- (iv) In the case of a listed company, in addition to those stipulated in Clause 49 of the Listing Agreement, Section _____ of the Companies Act 1956 contains additional requirements for Corporate Governance.

- (v) The Status of litigation and claims _____ (need to/ need not) be examined for evaluating going concern uncertainties.
- (vi) Annual returns of a Company should be filed with the Registrar of Companies within _____ from the date of annual general meeting. 1x6=6

Answer to Question No. 5 (a):

- (i) C
(ii) A
(iii) C
(iv) B

Answer to Question No. 5 (b):

- (i) 25%
(ii) Legal risks
(iii) 2 Directors
(iv) 292A
(v) Need to
(vi) 60 days

Question:

6. (a) MR. VASUDEB was appointed as Director of ZISLEEN LTD on 2nd April 2010. The Articles of Association of the Company provides that the qualification of a Director shall be holding of at least 10 shares in the company. Mr. Vasudeb applied for 10 equity shares of the Company on 31st May 2010. But the shares were allotted only at the Board Meeting held on 12th August 2010.
- Examine with reference to the relevant provisions of the Companies Act 1956 whether Mr. Vasudeb has complied with the requirements relating to qualification shares. If not what are the consequences? 5 + 2
- (b) State the importance of a remuneration Committee in the context of Corporate Governance. What are the responsibilities normally assigned to such a committee? 3 + 2
- (c) State any 3 of the additional requirements stipulated in Clause 49 of the Listing Agreement which are silent in Section 292A of the Companies Act 1956. 3

Answer to Question No. 6 (a):

The Companies Act 1956 does not provide for any share qualification of any director. But Regulation 66 of Table-A Provides that a director must hold at least one share in the Company.

Usually the Articles of a company provides for holding qualification share by a director. Where a share qualification has been prescribed in the Articles of a Company which is a public company or a private company, which is a subsidiary of a public company, the provision of section 270 regarding holding of share qualification by a director shall apply whereby such director must take his qualification share within 2 months after his appointment.

If a person acts as a director without acquiring the qualification shall in accordance. With the provision of section- 270, he shall be punishable with fine, which may be extending to Rs. 500 for every day during which he continues to act as director (section -272). Moreover a director who fails to hold qualification shares is liable to vacate his office. In this case MR. VASUDEB was appointed as

Director of ZISLEEN LTD on 2nd April 2010. He applied for shares of the Company on 31st May 2010 which was allotted only at the Board meeting held on 12th August 2010. Unless the shares applied for by Mr. Vasudeb has been allotted in his favour, it cannot be said that he held the shares before expiry to two months from the date of his appointment. Therefore Mr. Vasudeb must vacate his office.

Answer to Question No. 6 (b):

Remuneration Committee:

It is now a universally accepted proposition of corporate governance practice that Board of directors of companies appoint appropriately composed remuneration committees to work out executive remuneration of their behalf. The combined code of the UK says that the remuneration committee will be responsible for working out remuneration packages "to attract retain and motivate executives of the quality required".

The committee should decide where to position their company relative to other companies and take account of comparable remuneration and relative performance.

With regard to the composition of the Committee on overwhelming majority of guidelines suggest that it be composed exclusively of independent non-executive directors. The committee would make its well considered recommendations to the Board for final decision.

The following responsibilities are normally assigned to a remuneration committee, which should have written terms of reference:

- (i) Remuneration packages and service contracts of the ECO and other senior executives.
- (ii) Remuneration packages for non-executives directors
- (iii) Any company share and other incentive schemes.
- (v) Company superannuation and pension arrangements.

Answer to Question No. 6 (c):

Additional Requirements stipulated as per Clause 49:

The following additional requirements are stipulated as per clause 49 of the listing Agreements which are silent in Section 292A of the companies Act, 1956:

- (i) The Audit committee should write such of the executives as it considers appropriate (and particularly head of finance function) to be present at the meeting of the committee, but on occasions it may also met without the presence of any executive of the company.
- (ii) The company secretary shall act as secretary to the committee.
- (iii) The audit committee shall meet at least thrice a year. One meeting shall be held before finalization of annual accounts and once in every six months.
- (iv) The quorum of the audit committee shall be two members or one-third of the members of the audit committee- whichever is higher and minimum of two independent directors.
- (v) The powers and role of the audit committee are elaborately contained in sub-paragraphs C&D of Paragraph-II.

Question:

- 7.(a) Weak Tweek India Ltd made an initial public offer of 2 lakh equity shares. Can these shares be considered as 'Goods' under the Competition Act 2002 before allotment? 3
- (b) INSTABLE FERTILIZERS LTD has been continuously incurring losses; the company mortgaged its machinery to Mr. BULLY one of its creditors on 1st September 2009 relating to outstanding of

Rs. 15 lakhs due to him. The other creditors of the company filed a petition for winding up the Company on 19th December 2009. The company was ordered to be wound up on 30th April 2010. Discuss whether the Official Liquidator can declare the transaction of mortgage with Mr. Bully as invalid. 6

- (c) Write a brief note on Audit Committee. 6

Answer to Question No. 7 (a):

Share before allotment are not goods

As per section 2 (i) of the Competition Act, 2002, 'goods means goods as defined in the sale of Goods Act, 1930, and includes-

- (a) products manufactured, Processed or mined;
- (b) debentures, stocks and shares **after allotment**; and
- (c) goods imported in India.

Thus 'shares after allotment' can be construed as goods, but 'shares before allotment' are no goods.

Answer to Question No. 7 (b):

Mortgage in favour of a particular creditor can be declared void

In case of a winding up by the Court, the winding up shall be deemed to have commenced at the time of presentation of the petition for the winding up. Thus, where a petition is made to the court and the court orders the winding up, the order relates back to the date of the presentation of the petition.

As per the section 531, a transaction shall be deemed to be a fraudulent preference and consequently invalid if all the following conditions are fulfilled:

- (a) The transaction relates to transfer to property, delivery of goods, Payment of money or other act relating to the property of the company.
- (b) It took place within 6 months before the commencement of the winding up the company.
- (c) It was an entirely voluntary act and not made under any pressure.
- (d) The dominant motive was to give a creditor a preference over other creditors.

In the given case, the winding up of the company, commenced on 31st December 2009 that is the date of presentation of petition of winding up. The company had mortgaged its machinery in favour of the creditor on 1st September, 2009, i.e., within the 6 months before the commencement of winding up. The mortgage was voluntarily by the company, without any consideration, and not under any pressure. Thus, the dominant motive behind the transaction was to give the preference to Mr. Bully, the creditor over the others. Since all the requirements of Section 531 are satisfied in the given case, the mortgage of the machinery made in the favour of the creditor amounts to fraudulent preference, and is hence void. Therefore the Official Liquidator can declare the mortgage in favour of creditor Mr. Bully as void.

Answer to Question No. 7 (c):

Audit Committee:

An audit committee is an operation committee of the Board of Directors charged with oversight of financial reporting and disclosure. Section 292A of the Act requires every public company having paid-up capital of not less than rupees five crores to constitute an audit committee as a committee of the Board of Directors. This Committee shall consist of such number of directors as its members, as may be determined by the Board.

However, the number shall not be less than three. Audit committees are typically empowered to acquire the consulting resources and expertise deemed necessary to perform their responsibilities. The role of audit committees continues to evolve as a result of the passage of the Sarbanes–Oxley Act 2002. Many audit committees also have oversight of regulatory compliance and risk management activities. Not for profit entities may also have an audit committee.

Responsibilities of the audit committee typically include:

- Overseeing the financial reporting and disclosure process.
- Monitoring choice of accounting policies and principles.
- Overseeing hiring, performance and independence of the external/statutory Auditors.
- Oversight of regulatory compliance, ethics, and whistleblower hotlines.
- Monitoring the internal control process.
- Overseeing the performance of the internal audit function.
- Discussing risk management policies and practices with management.

Question:

8. (a) What do you mean by "Right to Information" according to the RTI Act 2004? What are the objectives of the said Act? 5
- (b) It is said that after risk identification takes place, the actions involved in pinpointing suitable responses to the risk are broadly of 5 types. Elaborate on these 5 types of action. 6
- (c) State any 8 of the 14 key aspects of the CII (Confederation of Industries) code for desirable Corporate Governance. 4

Answer to Question No. 8 (a):

A bill to operationalise the right to information by setting out the practical regime for people to secure access to information under the control of public authorities, consistent with public interest, in order to promote openness, transparency and accountability in relation to matters connected therewith or incidental thereto.

- (i) This Act may be called the Right to information Act-2004
- (ii) It extends to the whole of India except the state of Jammu and Kashmir
- (iii) It shall come into force within 120 days of it being enacted
- (iv) Where State Legislation exist dealing with the right to access information; a person will have the right to seek information under the State law as well as under this Act, if the information pertains to a subject under the State list in Schedule 7 of the constitution of India.

Objectives of the Act:

- Give effect of the fundamental Right to information, which will contribute to strengthening democracy, improving governance, increasing public participation, promoting transparency and accountability and reducing corruption.
- Establish voluntary and mandatory mechanisms or procedures to give effects to right to information in a manner which enable persons to obtain access to records of public authorities in a swift, effective inexpensive and reasonable manner.
- Promote transparency, accountability and effective governance of all public authorities by including but not limited to, empowering and educating all persons to: understand their rights in terms of this Act in order to exercise their rights in relation to Public authorities.

- Understand the functions and operation of public authorities; and effectively participating in decision making by public authorities that affects their rights.

Answer to Question No. 8 (b):

This step identifies the potential risk (or opportunities) facing the project. It is important not to judge the likelihood of a risk at this early stage. This is done in a controlled manner at a later stage. Attempting to form judgments while brainstorming a list of potential risks may lead to hurried and incorrect decision to exclude risks.

Once identified risks are all external in the risk log. This contains details of all risks, their assessment, owners and status. The risk log is a control tool for the project manager, providing a quick reference to the key risks facing the project, what monitoring activities should be taking place and by whom. Reference to it can lead to entries.

Identify suitable responses to risk:

The actions break into broadly 5 categories.

1. Prevention – Terminate the risk: by doing things differently and this removing the risk where it is feasible to do so. Countermeasures are put in place that either stop the threat or problem from occurring or prevent it having any impact on the project or business.
2. Reduction – of threat of Risk: take action to control it in some way where the actions either reduce the likelihood of the risk developing and limit the impact on the project to acceptable levels.
3. Transference: This is a special form to risk reduction where the management of the risk is passed to a third party via, for instance, and insurance policy or penalty clause, such that the impact of risk is no longer an issue for the health of the project. Not all risk can be transferred in this manner.
4. Acceptance: Tolerate the risk – perhaps because nothing can be done at a reasonable cost to mitigate it, or likelihood and impact or the risk occurring rate at an acceptable level
5. Contingency: These are action planned and organized to come into force as and when the risks occur.

Any given risk can have appropriate actions in any or all of these categories. There may be no cost-effective actions available to deal with a risk, in which case the risk must be accepted or the justification of the project revisited (to review if the project is too risky). This may possibly result in termination of the project. The results of the risk evaluation activities are documented in the risk log. If the project is part of a programme, project risk should be examined for any impact on the programme (and vice-versa). Where any cross-impact is found the risk should be added to the other risk log.

Answer to Question No. 8 (c):

Confederation of Indian Industries code for desirable Corporate Governance:

The CII has recommended the following 14 key aspects which should be shared with the Board

- (i) Annual operating plans and budgets together with updated long term plans
- (ii) Capital budgets, manpower and overhead budgets
- (iii) Quarterly results for the company as a whole and its operating divisions for business segments
- (iv) Show cause, demand and prosecution notice received from the revenue authorities which are considered to be materially important

- (v) Internal audit reports, including cases of theft and dishonesty of a material nature
- (vi) Fatal or serious accidents, dangerous occurrences, and any affluent or pollution problems.
- (vii) Default in payment of interest or non payment of the principal on any public deposit and/ or any secured creditors or financial institutions
- (viii) Default such as non-payment of inter-corporate deposits by or to the company or materially substantial non-payments for goods sold by the company.
- (ix) Any issue which involves possible public or product liability claims of a substantial nature, including any judgment or order which may have been passed, strictures on the conduct of the company, or taken an adverse view regarding another enterprise that can have negative implications for the company
- (x) Details of any joint venture or collaboration agreement
- (xi) Transactions that involve substantial payment towards goodwill, brand equity or intellectual property
- (xii) Recruitment and remuneration of senior officers just below the Board level, including appointment for removal of the Chief Financial Officer and Company Secretary
- (xiii) Labour Problems and their proposed solutions
- (xiv) Quarterly details of exchange exposure and the steps taken by the management to limit the risk if adverse exchange rate movement, if material