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.**

CONTENTS

FINAL EXAMINATION (SYLLABUS - 2008)

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FINAL EXAMINATION - GROUP III

(SYLLABUS - 2008)

SUGGESTED ANSWERS TO QUESTIONS

JUNE 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 (=1mark) and give your workings/reasons briefly (=1mark):

(i) The co-efficient of correlation between returns of SPARK LTD and SENSEX is 1.10.The expected returns on the stock of Spark and Sensex are 18% and 14.37% respectively. The return on 182 day T-Bill is 6.31%. What would be the standard deviation of the returns of Spark if the standard deviation of Sensex's return is 17%?

A. 20.12%
B. 22.41%
C. 26.46%
D. Insufficient data

(ii) SAFARI LTD has an excess cash of Rs. 6,00,000 which it wants in short term marketable securities. The securities invested will have an annual yield of 8%. If the expenses relating to investment in securities is Rs. 20,000, what would be the minimum period for the company to break even its investment expenditure? Ignore time value of money.

A. 9.50 months
B. 5.00 months
C. 3.75 months
D. Insufficient data

iii) MS. BRISTI can earn a return of 18% by investing in equity shares on her own. Now she is considering a recently announced Equity based Mutual Fund scheme in which initial expenses are 1% and annual recurring expenses are 2%. How much should the Mutual Fund earn to provide Ms Bristi, a return of 18%?

A. 18.18%
B. 20.18%
C. 22.18%
D. 22.78%

(iv) The Stock is currently selling at Rs. 270. The call option to buy the stock at Rs. 265 costs Rs. 12. What will be the Time Value of the option?

A. Rs. 13
B. Rs. 5
C. Rs. 17
D. Rs. 7

(v) The Spot value of Nifty is 4430. An investor bought a one month Nifty for 4410 call option for a premium of Rs. 12. The option is:

A. In the money
B. At the money
C. Out of the money
D. Insufficient data

2 x 5

(b) Choose the most appropriate one from the stated options and write it down. (Only indicate A,B,C,D as you think correct):

(i) There will be no conflict in ranking between Sharpe's ratio and Treynor's ratio, if the portfolio has:

A. Zero unsystematic risk
B. Zero systematic risk
C. Zero total risk
D. Equal amount of systematic risk and unsystematic risk

(ii) MS. ANKITA, an employee of MERLIN LTD was not able to earn profit from the information she had about the likely profit figure for the company, even after trying for an extended period of time. This means that the market is exhibiting:

A. Weak form of market efficiency
B. Semi-strong form of market efficiency
C. Super strong form of market efficiency
D. Inefficient market

(iii) SEBI (Disclosure and Investors Protection) Guidelines 2000 are applicable to:

A. All public issues by listed and unlisted Companies
B. Public sector Banks
C. Infrastructure Companies
D. Both (B) and (C) above

(iv) RBI has permitted some of the financial institutions like IDBI, ICICI etc. to borrow on the strength of money market instruments for a period of ____________ months to ____________ months.

A. 6, 9
B. 6, 12
C. 3, 6
D. 1, 12

(v) IRDA Act was passed in the year

A. 1987
B. 1993
C. 1999
D. 2003

1x 5

(c) Fill up the blanks with appropriate answers:

(i) A ____________ contains all information of the Company contents but does not have information on price of securities offered and number of securities (quantum) offered through such document to the public.

(ii) ____________ are those Institutional Investors generally perceived to possess expertise and the financial muscle to evaluate and invest in the Capital Market.

(iii) The risk attributable to factors unique to a security is ____________ .

(iv) Penalty imposed on a stock exchange for margin violation, for the first instance is ____________ .

(v) In the context of public issue, the expansion of RI is ____________ 1 x 5

Answer to Question No. 1(a)

(i) Answer: B: 22.41

$0.18 = RF + (R_m - R_F)\beta = 0.0631+0(0.1437 - 0.0631)$

Or, $\beta = 0.1169/0.0806 = 1.45$

Again $\beta = (\sigma_i P_{im} / \sigma_m)$

Or $\sigma_i = \beta\, \sigma_m / P_{im} = (1.45 \times 0.17)/1.1 = 0.2241$ i.e. 22.41%.

(ii) Ans : B: 5 months

Investment = Rs. 6,00,000

Let minimum period to break even its investment expenditure = P

Hence, 6,00,000 x 0.08x P/12 – 20,000 = 0

Or, 4000P = 20,000; i.e. P = 20,000/4,000 = 5 months

(iii) Ans: B: 20.18%

R2 = [1/(1- 0.01) x R1] + recurring expenses %

Where, R2 = Mutual fund earnings

R1 = Personal earning of Ms Bristi

R2 = 1/0.99 x 0.18 + 0.02 = 0.2018 i.e. 20.18%

(iv) Ans : D: Rs 7 ∴ (265 + 12) – 270 =7

(v) Ans: In the Money : Spot value > Exercise/Strike value => In the Money

Rs. 4430 > Rs. 4410

Answer to Question No. 1(b)

i. A : Zero unsystematic risk
ii. C : Super strong form of market efficiency
iii. A : All public issues by listed and unlisted companies
iv. C : 3,6
v. C : 1999

Answer to Question No. 1(c)

i. Red herring prospectus
ii. Qualified Institutional buyers
iii. Unsystematic risk
iv. 0.07% per day
v. Rights Issue

Question:

2.(a) Explain in brief the term 'Contango' and 'Backwardation' as used with respect to Future Contracts. 3

(b) Explain any 2 *methods* by which companies can raise funds through the primary market for setting up or expanding their business. 2

(c) In six month's time, Darjeeling Darlings Ltd., Bristol, United Kingdom will have to make a payment of $4,00,000. It is currently 1st June. With a view to hedge its transaction exposure, the company is contemplating the various alternatives:

Exchange rates:

Spot rate	$1.5719 - 1.5823
Six month forward rate	$1.5502 - 1.5704

Money market rates:

	Borrow (%)	Deposit(%)
US	6	4.5
UK	7	5.5

Foreign currency option prices (1unit is £ 12,500):

Exercise Price	Call option (December)	Put option (December)
$1.70	$ 0.037	$ 0.096

With the help of necessary calculations you are required to help Darjeeling Darlings Ltd in deciding which of the following hedging alternatives is the most favorable one:

(a) Forward market
(b) Cash (money) market
(c) Current options

Ignore time value of money (in case of premia). 15

Answer to Question No. 2(a)

Although the spot price and futures price generally move in line with each other, the basis is not constant. Usually basis decreases with time, until on the date of expiry, the basis is zero and futures price equals spot price.

Contango : If the futures price is greater than the spot price it is called contango.

Under normal market conditions futures contracts are priced above spot price. (This is known as contango market). In this case, the futures price tends price tends to fall over time towards the spot price, equaling spot on the day of delivery.

Backwardation: If the spot price is greater than the futures price it is called **backwardation.** In this case the futures price tends to rise over time to equal the spot price on the day of delivery.

Answer to Question No. 2(b)

Companies can raise funds through the primary market for setting up or expanding their business. Various methods include:

1. **By prospectus**: Capital can be raised from the general public by the issue of prospectus, which is an invitation to the general public for subscribing to the capital. It contains various details regarding the particulars of the company, its financial position etc
2. **By offer for sale:** This method is most similar to the prospectus except the difference that initially shares are taken by a third party in bulk. Later a statement like prospectus is issued for sale of shares to the public.
3. **By private placing:** Shares are sold to individuals or institutions directly by making a private appeal to them.
4. **By offering rights issue:** Companies may also raise capital from the existing shareholders by making a right issue. Under the rights issue, the shareholders have the right to a certain number of shares in proportion to the share held by them..

Answer to Question No. 2(c)

(A) Forward market

(i) Exposure = 4,00,000

(ii) Forward Rate 1£ = 1.5502

Outflow (6 months later)

$4,00,000/$1.5502 = 2,58,031

(B) Cash (Money Market)

(i) Maturity in $ after 6 months = $ 4,00,000

(ii) Present Value

{$4,00,000/(1+(0.045/2))} = 3,98,198

(iii) Borrow at spot to make up $ 3,91,198 = $2,48,870
(at 1£ = 1.5719)

(iv) Amount to be discharged including interest = £ 2,57,580
£ 2,48,870 x (1+ 0.07/2)

(C) Currency Options

(i) Number of contracts 4,00,000/21,250 = 18.82 contracts
(can be rounded off to 18 contracts)

(ii) Exposure covered through put option 18 x21,250 = $3,82,500

(iii) Balance to be covered through forward market $17,500
(4,00,000 - 3,82,500)

(iv) Premia payable is (18x12,500x0.096) $21,600
Premia payable is £13,741[using Spot Bid]
21,600/1.5719

(Fig in £)

	Put Option	Forward
Exposure covered	$ 3,28,500	$17,500
Premia	13,471	
18 Contract payment ($ 3,82,500/$1.70)	2,25,000	
Forward Pyt (17,500/1 5502)		11,289
	2,38,741	**11,289**

Total Cash outflow is 2,83,741 + 11,289 = £ 2,50,030

Conclusion: Currency options is to be chosen since the cash outflow is the minimum in the same.

Notes:

- The quote is indirect one.
- The quote is for per pound, expressed in dollars
- One unit or contract is equal to £ 12,500 of $ 21,250 (12,500 x 1.70)
- Time value of money for the payment of premia is ignored, as given in the problem.

Question:

3(a) Explain briefly the advantages of holding securities in "Demat" form rather than in physical form. 4

(b) State five important regulations prescribed by SEBI for the investments that can be made by a Mutual Fund. 5

(c) The stock of MOULIN LTD is currently trading at Rs. 500 and call option exercisable in three months time and has an exercise rate of Rs. 488. The standard deviation of continuously compounded stock price change for MOULIN LTD is estimated to be 20% per year. The annualized Treasury bill rate corresponding to this option life is 6% p.a. The company is going to declare a dividend of Rs. 15 and it is expected to be paid in two months time.

Requirements:

(i) Determine the value of a three-month call option on the stock of MOULIN LTD (using Black Scholes model)

(ii) What would be the value of Put Option if the current price of stock is considered to be Rs. 485.15?

Note: Extracted from tables:

(1) Natural Logarithm: ln (0.99416) = - 0.005857
ln (1.02459) = 0.024929

(2) Value of e^{-x} : $e^{-0.02}$ =0.9802, $e^{-0.015}$ = 0.9851

(3) For N(x) : Where X $\geq$ 0 : N(0.1414) = 0.5562
N(0.0414) = 0.5165
Where X $\leq$ 0 : N(-0.1414) = 0.4438
N(-0.0414) = 0.4835

(4) PVIF (6%, 0.25 years) = 0.9852, PVIF(6%,1/6 year) = 0.9901 5+2

(d) What is the settlement schedule for the Interest Rate Futures contracts for:

(i) Daily Mark-to-Market settlement

(ii) Final settlement 2+2

Answer to Question No. 3(a)

The Depositories Act 1996 provides the framework for the establishment and working of depositories enabling transactions in securities in scripts or (demat) form with the arrival of depositories on the scene, many of the problems previously encountered in the market due to physical handling of securities have been to a great extant minimized.

In a broad sense, therefore, it can be said that 'dematting' has helped to broaden the market and make it smoother and more efficient.

From an **individual investor** point of view, the following are important advantages of holding securities in demat form.

- It is faster and avoids delay in transfers.
- It avoids lot of paper work.
- It saves on stamp duty.

From the **issuer company** point of view also, there are significant advantages due to dematting some of which are:

- Saving in printing certificates, postage expenses
- Stamp duty waiver
- Easy monitoring of buying/Selling patterns in securities increasing ability to spot takeover attempts at price rigging.

Answer to Question No. 3(b)

SEBI REGULATIONS FOR INVESTMENTS OF A MUTUAL FUND

The investments of a mutual fund are governed by a set of regulations of the SEBI and the five important ones are as under:

(i) In all the schemes taken together, a mutual fund shall not own more than 10% of the company's paid up capital;

(ii) A scheme shall not invest more than 15% of the NAV in debt instruments issued by a single issuer which are rated not below investment grade by an authorized credit rating agency;

(iii) Barring certain expectations, a scheme shall not invest more than 10% of its NAV in the equity shares or equity related instruments of one company;

(iv) A scheme shall not invest in more than 5% of its NAV in unlisted equity shares or equity related instruments in case of an open ended scheme and 10% of its NAV in case of close ended scheme;

(v) Mutual funds shall mark all investments to market.

Answer to Question No. 3(c)

MOULIN LTD

(i) Since dividend is expected to be paid in two months time, we have to adjust the stock price and then use Black and Scholes model to value the option.

P.V. of the expected dividend : 15 x 0.9901 = Rs. 14.85

Dividend adjusted stock price: Rs. 500 – Rs. 14.85 = Rs. 485.15

Valuation of CALL OPTION : (using Black & Scholes Model)

$V_o = V_s.N(d1) - Ee^{-rt}N(d2)$

Where, V_s = current price of stock (adjusted) = Rs. 485.15

E = exercise price = Rs 488, r = Risk free rate = 0.06

$$d1 = \frac{\ln (V_s/E) + [r + i/2\,\sigma^2] \times t}{\sigma\sqrt{t}}$$

$$= \frac{\ln (488.15/488) + [0.06 + ½(0.20)^2] \times 0.25}{0.20\sqrt{0.25}}$$

$$= \frac{\ln (0.99416) + 0.02}{0.10} = (-0.005857 + 0.02)/0.10 = 0.1414$$

d2 = 0.1414 – 0.10 = 0.0414

N(d1) = N(0.1414) = 0.5562

N(d2) = N(0.0414) = 0.5165

Value of Call Option (Vo) = Vs . N(d1) – Ee^{-rt}N(d2)

Where $e^{-rt} = e^{-0.06+0.25} = e^{-0.015} = 0.9851$

Therefore, Vo = (485.15 x 0.5562) – (488 x 0.9851 x 0.5165)

= 269.84 – 248.30 = Rs 21.54

(ii) Value of Put Option : Xe^{-rt} [1 – N(d2) – S[1 – N(d1)]

= 488 x 0.9851[1 – 0.5165] – 485.15[1 – 0.5562]

= 232.43 – 215.31 = Rs. 17.12

Answer to Question No. 3(d)

Settlement schedule for interest Rate Future contracts

	Pay - in	Pay - out
Daily Mark to Market settlement	T + 1 working day, on or after 11.30 a.m	T+ 1 working day, on or after 12:00 p.m.
	(For above, T is the trading day)	
Final Settlement	T + 1 working day, o or after 11.30 a.m	T+ 1 working day, on or after 12:00 p.m.
	(For above, T is the expiration day)	

Question:

4(a) The target payout ratio for DYNAMIC SUPERMACHINES LTD. is 0.4. The dividend per share for the current year is Rs. 14. The dividend per share in previous year was Rs. 12. The weightage given to the current year earnings is 0.60. The number of Equity Shares outstanding in the company is 10,00,000. If P/E multiple is 9, applying Lintner Model of dividend policy to the company, compute the market capitalization of the company. 5

(b) MR. ANKAN ANAND an analyst at REVAMP SECURITIES LTD. has made risk and return projections for the securities of GLOBSIN LTD and ASHEEKA LTD which are as follows:

Scenario	Probability	Return on Globsin Ltd (%)	Return on Asheeka Ltd (%)	Market Return (%)
2% GDP growth	0.03	-5	21	-20
4% GDP growth	0.10	4	15	-5
6% GDP growth	0.27	10	0	10
8% GDP growth	0.20	18	-1	20
9% GDP growth	0.40	25	-4	30

It is felt that the interest rate of 5.60% on the 91 day T-bill is a good approximation of the risk free rate. Assuming that CAPM holds good in the market answer the following:

(i) Calculate Ex-ante betas for both the companies

(ii) Calculate Ex-ante alpha for both the companies

(iii) Determine the proportion of systematic risk and unsystematic risk in the two stocks

(iv) State whether the stock of Globsin Ltd and Asheeka Ltd are underpriced or overpriced

6+3+4+2

Answer to Question No. 4(a)

cDt = dividend per share for the current year

c = weightage given to the current earnings of the firm

r = target payout ratio

EPSt = earnings per share for the current year

D_{t-1} = dividend per share for the previous year

$D_t - D_{t-1}$ = target change

Dt = target ratio x (EPSt – D_{t-1})

14 = 0.6 x .04 x EPSt + (1 – 0.6)12

14 = 0.24 x EPSt + 0.4 x 12

0.24 EPSt = 14 – 4.8

EPSt = 38.33

P.E. multiple = 9

Market capitalization = 38.33 x 9 x 10,00,000 = Rs. 34,49,70,000

Answer to Question No. 4(b)

Please note: In this Answer $\sqrt{70.24}$ = sq rt (70.24)

(i) Expected return on stock and variance of Globsin Ltd:

$E(R_G)$ = 0.03 x -5 + 0.10 x 4 + 0.27 x 10 + 0.20 x 18 + 0.40 x 0.25 = 16.55%

$\sigma^2_G = 0.03(-5 - 16.55)^2 + 0.10(4 - 16.55)^2 + 0.27(10 - 16.55)^2 + 0.20$

$(18 - 16.55)^2 + 0.40(25 - 16.55)^2$

= 13.93 + 15.75 + 11.58 + 0.42 + 28.56 = 70.24

$\sigma_G = \sqrt{70.24}$ = sq rt (70.24) = 8.38%

Expected return on stock and variance of Asheeka Ltd:

E(RA) = 0.03 x 21 + 0.10 x 15 + 0.27 x 0 + 0.20 x -1 +0.40 x -4 = 0.33%

$\sigma^2_A = 0.03(21 - 0.33)^2 + 0.10(15 - 0.33)^2 + 0.27(0 - 0.33)^2 + 0.20(-1 - 0.33)^2 + 0.40(-4 - 0.33)^2$

= 12.82 + 21.52 + 0.029 + 0.35 + 7.50 = 42.22%

Standard Deviation

$\sigma_A = \sqrt{42.22} = 6.50\%$

MARKET:

Expected Return and Variance on Market:

E(Rm) = 0.03 x – 20 + 0.10 x – 5 + 0.27 x10 + 0.20 x 20 + 0.40 x 30 = 17.60%

$\sigma^2_m = 0.03(-20 - 17.60)^2 + 0.10(-5-17.60)^2 + 0.27(10 - 17.60)^2 + 0.20(20 - 17.60)^2$

$+ 0.40(30 - 17.60)^2 = 171.74\%$

$\sigma_m = \sqrt{171.74} = 13.10\%$

Covariance (Globsin, Market) :

= 0.03(-5-16.55)(-20 – 17.60) + 0.10(4 – 16.55)(- 5 – 17.60) + 0.27(10 – 16.55) (10 – 17.60) +

0.20(18 – 16.55) (20 – 17.60) + 0.40(25 – 16.55) (30 – 17.60)

= 24.30 + 28.36 + 13.44 + 0.696 + 4.91

= 108.72%

Covariance (Asheeka, Market):

= 0.03(21 – 0.33)(- 20 – 17.60) + 0.10(15 – 0.33) (- 5 – 17.60) + 0.27(0 – 0.33) (10 – 17.60)

= - 23.32 – 33.15 + 0.68 – 0.64 – 21.48

= - 77.91

Beta of Globsin : $\beta_G = \dfrac{Cov.(G, M)}{\sigma^2_m} = \dfrac{108.72}{171.74} = 0.6330$

Beta of Asheeka : $\beta_A = \dfrac{Cov.(A,M)}{\sigma^2_m} = \dfrac{-77.91}{171.74} = -0.4536$

(ii) The equation of security market line is

$R_i = R_F + (R_m - R_F)\,\beta_i$

Require rate of return of Globasin :

R_e(G) = 5.60 + (17.60 – 5.60) (0.6330) = 13.196 is 13.20

Ex ante Alpha of Globsin = E(RG) – Re(G)

= 16.55 – 13.20

= 3.35%

Required rate of return of Asheeka:

R_e(A) = 5.60 + (17.60 – 5.60) (-0.4536) = 0.16%

Ex ante Alpha of Asheeka = E(RA) – Re(A) = 0.33 – 0.16 = 0.17%

(iii) Systematic risk of Globsin = $\sigma^2_m \beta^2_G$

= 171.74 x $(0.6330)^2$ = 68.81%

Unsystematic risk = Total Risk – Systematic Risk

= 70.24 – 68.81

= 1.43%

Systematic risk of Asheeka = $\sigma^2_m \beta^2_A$

= 171.74 x $(0.4536)^2$

= 35.34%

Unsystematic risk = 42.22 – 35.34

= 6.88%

Globsin Ltd:

Proportion Systematic risk = 68.81/(70.24) x 100 = 97.96%

Proportion Unsystematic risk = 100 – 97.96 = 2.04%

Asheeka Ltd:

Proportion Systematic risk = 35.34/(42.22) x 100 = 83.70%

Proportion of Unsystematic risk = 100 – 83.70 = 16.30%

(iv) Since stock Globsin Ltd. and Asheeka Ltd. both have positive ALPHA (3.35% and 0.17% respectively), therefore, they are UNDERPRICED.

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) State with reasons whether true or false (*Mere conclusion will not suffice):*

(i) A company having a paid-up share capital of Rs. 50 lakhs or more can appoint a sole selling agent with the approval of the Central Government.

(ii) A statement in lieu of prospectus filed when shares are not issued to public, but private sources need to be signed by any two Directors of the company.

(iii) The guidelines for good Corporate Government 2009 brought out by Ministry of Company affairs are for voluntary compliance and are not mandatory. 2 x 3

(b) Fill up the blanks with the appropriate answers:

(i) Alternation of share capital requires the passing of ____________ resolution.

(ii) Mr. Anup Kumar is a director of SHEETAL LTD which failed to file its annual return from the year 2006-07. The maximum period for which Mr. Anup will be disqualified from becoming a director in any Public Limited Company is ____________ years.

(iii) Clause ____________ of the Listing Agreement deals with principles of Corporate Governance.

(iv) The ____________ Committee set up by SEBI submitted its report in February 2003 on Corporate Governance 1 x 4

Answer to Question No. 5(a)

(i) **FALSE**

A company having a paid up capital of Rs 50 lakhs or more shall not appoint a sole selling agent expect with the consent of the company according by a special resolution and the approval of the Central Government. Thus passing of a special resolution in a meeting of members is also required.

(ii) **FALSE**

Statement in lieu of prospectus needs to be signed by every person who is named as director in the statement.

(iii) **TRUE**

The recently guidelines for good Corporate Governance 2009 brought out by the Ministry of Companies Affairs are for voluntary compliance and emphasize that good Corporate Governance practices enhance companies' value and stakeholders' trust resulting in robust development of capital market, the economy and also helps in the evolution of a vibrant and constructive shareholders' activism.

Answer to Question No. 5(b)

(i) Ordinary

(ii) 5 years

(iii) 49

(iv) Narayana Murthy Committee

Question:

6(a) The official Liquidator of VASUDHA LTD receives a notice from a trade creditor of the Company that the court has passed a decree in its favour, relating to the dues for services rendered to VASUDHA LTD, and the amount specified in the court decree should be paid first, prior to the clearing of dues of workmen. The same is opposed by the workmen. Advice the official Liquidator suitably; with reference to provisions of the Companies Act, 1956. 7

(b) An application was filed by Mr. Lalit Modi under Sec. 403 of the Companies Act, 1956 seeking direction to an annual general meeting (AGM) scheduled to be held on 10th June, 2010 at the factory premises instead of the registered office of the company, and also to adopt the accounts and reappointments of auditors at the AGM, in accordance with the outcome of his petition. The respondents submitted that the applicant was a party to the meeting held for the amendment of articles 15 and 16 and to substitute a new Article 16, that the petitioner had signed the Minutes and that the necessary From 23 and filed with the Registrar of companies for shifting the registered office to its new location. Is the claim of the applicant tenable? 4

(c) Where the Central Government is of the opinion that a number of the Competition Commission has acquired such financial interest that would affect prejudicially his functions as member of the Commission, can such a member be removed? Explain with reference to the relevant provisions of the Competition Act, 2002. 4

Answer to Question No. 6(a)

The situation in the question is covered by the provisions of section 529A of companies Act, 1956 read with section 529 and 530.

The effect of combined reading of these sections that the workmen of the company become secured creditors by operation of law to the extent of the workmen's dues and are entitled to proportional payment along with other secured creditors.

If there is no secured creditor then the work men of the company become unsecured preferential creditors under the said 529A to the extent of workmen's dues.

The purpose of the said section 529A is to ensure that the workmen should not be deprived of their legitimate claims in the event of the liquidation of the company and the assets of the company would remain charged for the payment of workmen's dues and such charge will be pari passu with the charge of other secured creditors. There is no other statutory provisions overriding the claim of the secured creditors except the said section 529A.

Thus under the said section 529A, the dues of the workmen and the debt due to the secured creditors are to be treated pari passu and have to be treated as prior to all other dues.

Thus, the law is very much clear in this respect and the Hon'ble Supreme court of India held in the case of [UCO BANK (1994) 81 comp, Case 780] that the provisions of Section 529A of the Companies Act 1956 will over ride all other claims of the creditors even where a decree has been passed by a Court.

In view of the stated legal position, the contention of the workmen of VASUDA LTD is valid and the official liquidator will have to pay their dues as provided in section 529A of the Companies Act.

Answer to Question No. 6(b)

No. Mr Lalit Modi, the applicant/petitioner is not correct in his claim, since all the formalities for shifting the registered office of the company were undertaken duly taking the approval of the shareholders in a properly convened meeting in which the petitioner/applicant also had participated and signed in the

Minutes for the alteration of Articles of Association, his present request for changing of venue of AGM is not tenable.

As per Sec. 166(2), the Company has to hold the AGM only at its Registered Office and there is no reason to shift the proposed meeting to a new location.

It was so held by the Company Law Board in MYLSAMY Vs. SRI GAJENDIRA PAPER AND BOARDS P.LTD (2009) 153 Comp Cas 2 (CLB) and the application was dismissed.

Answer to Question No. 6(c)

Provisions of section – 11(2) of the competition Act, 2002 empower the Central Government to remove, by an order, a member of the Competition Commission of India from his office if such member has acquired such financial interest as is likely to affect as is likely to affect prejudicially his functions as a Member of the Competition Commission.

However , Provisions of section – 11(3) of the said Act put some restrictions on such powers of the Central Government.

According to this section, in case as stated in the question, the Central Government wants to remove a member of the Competition Commission from his office, it has to make a reference to the Supreme Court. The Supreme Court shall hold an enquiry in accordance with the procedure formulated by it and report that the member in question ought to be removed from his office.

Thus, the Central Government can remove a member of Competition Commission from his office by following the above procedure.

Question:

7(a) LMN LTD was incorporated on 1st June,2007. On 1st March 2010 a political party approaches the company for a contribution of Rs. 10 lakhs for political purposes. Your advice is sought with respect to the under mentioned issues:

(i) Is the company legally authorized to give this political contribution?

(ii) Will it make any difference if the company was in existence on 1st April,2007?

(iii) Can the company be penalized for violation of the applicable provisions relating to political contribution?

(iv) What are the disclosure requirements in this regards? 2+2+2+2

(b) The Audit Committee of LATHA PHARMA LTD constituted under section 292A of the Companies Act, 1956 submitted to the Board of Directors a report containing its recommendations. These recommendations were however not accepted by the Board. In this scenario state your views on the following:

(i) Can the Board adopt the stand of not accepting the audit Committee's recommendations?

(ii) If yes, that the Board does not accept the recommendations what should the Board do?

(iii) How should the Chairman of the Audit Committee respond? 2+2+3

Answer to Question No. 7 (a)

(i) Only a company which had been in existence for 3 years can make contribution to political parties. Since LMN Ltd had not completed three years of existence on 1st March, 2010 it is not eligible to give political contribution.

(ii) Yes, Because in that case, LMN Limited shall complete three financial years of its existence, therefore, will be eligible to give political contribution.

(iii) A company will be eligible to give political contribution subject to the condition that such a contravention of the provisions of this section will make a company liable to fine which may extend to three times the amount so contributed.

Further every officer of the company in default would be liable to imprisonment for a term which extended to three years and also to fine.

(iv) The amended section 293A seeks to impose an obligation on every company to disclose in its profit and loss account contributions made by it to any political party or for any political purpose. Contravention of the provisions of this section will make a company liable to fine which may extend to three times the amount sô contributed. Further every officer of the company in default would be liable to imprisonment for a term which may extend to three years and also to fine.

Answer to Question No.7(b)

(i) As per Section 292A (6) the recommendations of the Audit Committee shall be binding on the Board of Directors, in so far as relating to the Financial Management including audit report. In respect of others matters, the recommendations are not bringing on the board.

(ii) Section 292A(7) enjoins that if the Board does not accept the recommendations of the Audit Committee, it shall record the reasons therefore and communicate such reasons to the share holders.

(iii) As per Section 292A(10) of the Companies Act 1956, the chairman of the Audit Committee shall attend the Annual General Meeting(s) of the company to provide any clarifications on matters relating to audit. Beyond this, the Chairman of the Audit Committee cannot do anything in the case of non – listed companies. It may be noted that in case of listed companies, clause 49 of the listing Agreement gives more power to the Audit Committee in this context.

Question:

8(a) SEBI has introduced Corporate Governance in a comprehensive manner to protect shareholders interests as well as provide teeth in monitoring Companies' performance through independent Directors. Discuss. 6

(b) State some of the procedures which an auditor has to follow in order to evaluate going concern uncertainties. 6

(c) What were the recommendations of the Narasimhan Committee relating to percentage of independent directors? 3

Answer to Question No. 8(a)

An outline provided by the **Confederation of Indian Industry** (CII) was given concrete shape in the Birla Committee report of SEBI, SEBI implemented the recommendations of Birla Committee and the Narayana Murthy Committee worked for further refining the rules of SEBI. These recommendations were implemented through the enactment clause 49 of the listing agreements.

The Committees which were created for the purpose were:

1. Audit Committee
2. Share holders grievance Committee
3. Remuneration Committee
4. Share Transfer Committee

Audit Committee :

Audit Committee has been empowered to discuss the performance of the company both from the point of view of interest of shareholders and efficiency. This Committee also discussed in detail quarterly performances taking care for proper disclosures and transparency. The annual report included a report on a corporate Governance, Corporate Social responsibility and Management discussions on future plans.

Shareholders Grievance Committee:

The interests of the shareholders regarding dividend payments, changes of addresses, any grievance against the company were discussed and disposed of every quarter and the status is indicated in the quarterly report.

Remuneration Committee:

Remuneration of whole time Managing Directors was recommended after application of mind as well as the relevant sections of the companies Act approval in the General Meetings of the Share holders.

Share transfer Committee :

With dematerialization, transfer of shares have become more transparent. However, the Committee looks into the aspects of insider trading and any possibilities and malpractices.

Answer to Question No. 8(b)

Evaluating the going concern uncertainties

In order to evaluate various going concern uncertainties an Auditor needs to follow certain procedures which may include

1) Analyze and discuss cash flow, profit and other relevant forecasts with management
2) Review events occurring after the balance sheet date for items affecting the entity's ability to continue as a going concern
3) Analyze and discuss the entity's latest available interim financial statements
4) Review the terms of debentures and loan agreements and determine whether any have been breached
5) Read minutes of the meeting of shareholders, the board of directors and important committees for reference to financing difficulties.
6) Review the status of matters under litigation and claims
7) Confirm the existence legality and enforceability of arrangements to provide or maintain financial support with related and third parties and assess the financial ability of such parties to provide additional funds.
8) Considering the entity's position concerning unfilled orders.

Answer to Question No. 8(c)

RECOMMENDATION: PERCENTAGE OF INDEPENDENT DIRECTORS.

No less than 50 percent of the board of director of any listed company, as well as unlisted public limited companies with a paid up share capital and free reserves of Rs. 10 crores and above, or turnover of 50 crores and above, should consist of independent directors — independence being defined in earlier recommendation.

However this will not apply to

(1) Unlisted public companies, which have no more than 50 shareholders and which are without debt of any kind from the public, bank or financial institution, as long as they do not change their character.

(2) Unlisted subsidiaries of listed companies.

Nominee directors will be excluded both from the denominator.

FINAL EXAMINATION – GROUP-III
(SYLLABUS - 2008)

SUGGESTED ANSWERS TO QUESTIONS

JUNE 2010

PAPER – F-P12 : FINANCIAL MANAGEMENT AND INTERNATIONAL FINANCE

Suggested Solution

Part - A (Compulsory)

Q.1. (a) In each of the cases given below, one out of four answers is correct. Indicate the correct answer and give workings/reasons briefly in support of your answer :

(i) LEENZA LTD. currently pays a dividend of Rs. 4 per share that is expected to grow at a rate of 10% for the next year, after which it is expected to grow at a rate of 7% forever. What value would you place on the stock of this company if a 15% rate of return is required? (Round off your answer to the nearest integer). [Given PVIF (15% 1 year) = 0-8696.]

A. Rs. 53.05

B. Rs. 55.00

C. Rs. 58.10

D. None of the above

(ii) The Degree of Operating Leverage (DOL) and the Degree of Financial Leverage of ALANTA LTD. are 3 and 1.67 respectively. If the management of the company targets to increase the EPS by 10 per cent, by how much percentage should sales volume be increased? (Round off your answer to the nearest value).

A. 5.00%

B. 3.00%

C. 2.00%

D. Insufficient data