

# GUIDELINE ANSWERS

## EXECUTIVE PROGRAMME

*(New Syllabus)*

JUNE 2019

MODULE 2



**THE INSTITUTE OF  
Company Secretaries of India**

**भारतीय कम्पनी सचिव संस्थान**

**IN PURSUIT OF PROFESSIONAL EXCELLENCE**

Statutory body under an Act of Parliament

(Under the jurisdiction of Ministry of Corporate Affairs)

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The Guideline Answers contain the information based on the Laws/Rules applicable at the time of preparation. However, students are expected to be well versed with the amendments in the Laws/Rules made upto **six** months prior to the date of examination.

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**EXECUTIVE PROGRAMME EXAMINATION**  
JUNE 2019  
**CORPORATE & MANAGEMENT ACCOUNTING**

Time allowed : 3 hours

Maximum marks : 100

Total number of questions : 6

- NOTE :** 1. Answer **ALL** Questions.  
2. **ALL** working notes should be shown distinctly.  
3. Name of the company is used only for illustration purpose.

**PART I**

**Question 1**

*Explain the following :*

- (a) *Parameters those are to be kept in mind during the time of raising and drafting the Audit queries.*
- (b) *State the advantages of subdivision of Ledger.*
- (c) *Features of International Financial Reporting Standards. (5 marks each)*

**Answer 1(a)**

The following parameters are looked during audit queries:

- 1. Any questions related to a company which is being audited either by an internal or external auditor.
- 2. The final touch of the accounts.
- 3. Audit query is the matter being investigated while examining financial report of a company.
- 4. Audit queries are questions asked by an auditor during an investigation. These may be used to gather information to come to a conclusion in the audit.
- 5. An audit query is an explanation that is required by the audit team on certain points that they may have identified during an audit.
- 6. Audit query is asked by the auditors to justify an action - e.g., invoice accrual prepayment, etc.
- 7. It is an inquiry from an auditor also known as findings.
- 8. Audit queries are questions asked by the auditor during an investigation. The response can be used to help the auditor come to a conclusion regarding an audit.
- 9. An audit query is when a particular set of data is pulled to audit.

**Answer 1(b)**

The advantages of subdivision of ledger are:

- 1. *Easy to divide work* : As a result of subdivision, records can be maintained efficiently by the concerned employee.

2. *Easy to handle* : As a result of subdivision, the size and volume of ledger is reduced.
3. *Easy to collect information* : From the different classes of ledger any particular type of transaction can be found out easily.
4. *Minimizations of mistakes* : As a result of subdivision chances of mistakes are minimized.
5. *Easy to compute* : As a result of subdivision, the calculations in accounting may be computed quickly which is very helpful to the management.
6. *Fixation of responsibility* : Due to subdivision, allotment of different types of work to different employees is done for which concerned employee will be responsible.

**Answer 1(c)**

Features of International Financial Reporting Standards (IFRS) are:

1. Single set of Accounting Standards based on fair value that would enable internationally to standardize and assure better quality on a global screen.
2. It would also permit international capital to flow more freely, enabling companies to develop consistent global practices on accounting problems.
3. It would be beneficial to the regulators too, as the complexity associated with the understanding of various reporting regimes would be reduced.
4. For investors, it gives a better understanding to the financial statements and assess the investment opportunities available in foreign countries other than their home country.
5. It also benefits the accounting professionals in a way that they will be able to sell their services in the different parts of world.

**Attempt all parts of either Q. No. 2 or Q. No. 2A**

**Question 2**

- (a) *During the course of the meeting of Board of directors' of Yana Ltd., it has been decided to forfeit the 500 shares held by Aasha on account of non-payment of the call amount of ₹4 per share. It has been informed that the face value and the called up value per share is ₹10. Based on the resolution passed in the meeting of Board of directors, shares of Aasha have been forfeited. In turn, 300 forfeited shares are reissued at the rate of ₹9 per share. You are required to pass the journal entries in the books of Yana Ltd. (5 marks)*
- (b) *Aarvi Ltd. has availed a loan of ₹150 lakh from Bank of India and issued to the Bank of India as collateral security - 2,50,000 debentures bearing interest rate of 9%, and of the face value of ₹100 each.*

*From the above information, you are required to :*

- (1) *Pass the necessary journal entries in the books of Aarvi Ltd.; and*

- (2) Show the presentation of the position in the Aarvi Ltd.'s Balance Sheet, as per Schedule III of the Companies Act, 2013. (3 marks)
- (c) What are the salient features of Ind AS-103 on "Business Combination" ? (3 marks)
- (d) Elaborate the guidelines provided by SEBI with respect to creation of Debenture Redemption Reserve. (5 marks)
- (e) The following information is extracted from the Balance Sheet of Chika Ltd. as at 31st March, 2019 :

<b>Name of Account</b>	<b>(₹ Amount in lakh)</b>
Term Loans	250
Capital Redemption Reserve	210
Unpaid Dividends	21
Securities Premium Reserve	115
Deferred Tax Liabilities	65
Interest Received in Advance	10
Statement of Profit and Loss (Debit)	118
Loans repayable on demand	32
9% Debentures	400

You are required to make the presentation of above information in the Relevant notes to the accounts for the year ended as at 31st March, 2019 as per Schedule III of the Companies Act, 2013. The Relevant notes should be related to :

- (1) Reserves and surplus
- (2) Non-current liabilities, and
- (3) Current liabilities. (3 marks)

**OR (Alternate question to Q. No. 2)**

**Question 2A**

- (i) The following balances were shown in the Balance Sheet of Geeta Ltd. as at 31st March, 2019 :

<b>Particulars</b>	<b>Amount (₹ in lakh)</b>
500 lakh Equity Shares of ₹10 each fully paid up	5,000
50 lakh, 8% Preference Shares of ₹10 each ₹8 paid up	400
Capital Reserve	1,950
General Reserve	2,500
Securities Premium Reserve	4,000
Surplus	210
12% Debentures	1,800
Non-Current Investments at cost	3,200
Cash and Bank	2,800

*Additional Information :*

- (1) The company passed a resolution in the Board of directors' meeting, to buy-back 20% of its equity share capital at ₹45 per share. For this purpose, it sold its investments of ₹2,200 lakh for ₹2,500 lakh.
- (2) Included in its investments were "Investments in own debentures" costing ₹150 lakh (face value ₹180 lakh). These debentures were cancelled as per Board of directors' meeting's resolution.

You are required to pass necessary journal entries in the books of Geeta Ltd.  
(5 marks)

- (ii) From the following information, work out the Economic Value Added by Vije Ltd.:

<b>Particulars</b>	<b>Amount (₹ in lakh)</b>
Shareholders' Fund	4,200
Long-term Debt	1,800
Trade Payables	750
Net Operating Profit before Interest and Tax	2,150

The average rate of return expected by shareholders' from similar types of companies is 20%. Risk free rate is 10%, and corporate tax rate applicable for Vije Ltd. is 30%.  
(5 marks)

- (iii) Beta Ltd. is a subsidiary of Alpha Ltd. The following is the Balance Sheet of Beta Limited as at 31st March, 2019 :

<b>Particulars</b>	<b>Amount (₹ in lakh)</b>
<b>EQUITY AND LIABILITIES</b>	
1. Shareholders' Funds	
(a) Share Capital : Equity Shares of ₹10 each	300
(b) Reserves and Surplus (Statement of Profit and Loss)	250
2. Non-current Liabilities : 8% Debentures	200
3. Current Liabilities	160
<b>Total Equity and Liabilities</b>	<b>910</b>
<b>Assets</b>	
1. Non-current Assets :	
Tangible Assets :	
Land and Building	270
Plant and Machinery	350
2. Current Assets	290
<b>Total Assets</b>	<b>910</b>

On 1st April, 2018, Alpha Ltd. acquired 24 lakh equity shares of Beta Ltd. at a cost of ₹460 lakh. On that date, Statement of Profit and Loss of Beta Ltd. showed a credit balance of ₹180 lakh and Land & Building was revalued by Alpha Ltd., at 20% above book value of ₹300 lakh (but no such adjustments are shown in the books of Beta Ltd.). You are required to calculate :

(1) Cost of Control, and

(2) Minority Interest.

(5 marks)

**Answer 2(a)**

**Journals of Yana Ltd.**

S. No.	Particulars		Rs.	Rs.
1.	Equity share capital a/c	Dr.	5,000	
	To Share forfeiture a/c			3,000
	To Calls in arrear a/c			2,000
	(being forfeiture of 500 shares for non-payment of first call)			
2.	Bank a/c	Dr.	2,700	
	Share forfeiture a/c	Dr.	300	
	To Equity share capital a/c			3,000
	(being re-issue of 300 forfeited shares @ Rs. 9 per share)			
3.	Share forfeiture a/c	Dr.	1,500	
	To Capital Reserve A/c			1,500
	(being amount already received in respect of forfeited shares @ Rs. 6 per share transferred to Capital reserve a/c after adjustment of discount on re-issue of forfeited share.)			

**Answer 2(b)**

(Rs. in lakh)

S. No.	Particulars		Rs.	Rs.
1.	Bank a/c	Dr.	150	
	To Bank Loan a/c or Loan from Bank of India a/c			150
	(Being a loan of Rs. 150 lakhs taken from Bank of India)			
2.	Debenture Suspense a/c	Dr.	250	
	To 9% Debenture a/c			250
	(being 9% debentures worth Rs. 250 lakh issued as collateral security for a bank loan taken from Bank of India)			

**Balance sheet of Aarvi Ltd. as at.....***(Rs. in lakh)*

<i>Particulars</i>	<i>Note</i>	<i>Amount (Rs.)</i>
<b>EQUITY AND LIABILITIES</b>		
<b>Non- current liabilities</b>		
Long term borrowings:		
9% Debentures of Rs. 100 each		250
Bank loan		150
<b>ASSETS</b>		
<b>Non-current assets</b>		
Other non-current assets:		
Debenture Suspense A/c		250
<b>Current assets</b>		
Bank		150

**Answer 2(c)**

The objective of Ind AS 103 on 'Business combination' is to improve the relevance, reliability and comparability of the information that a reporting entity provides in its financial statements about a business combination and its effects. To accomplish that, this Indian Accounting Standard establishes principles and requirements for how the acquirer:

- (a) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree;
- (b) recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and
- (c) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination.

**Answer 2(d)****SEBI guidelines on Creation of Debenture Redemption Reserve (DRR)**

1. A company has to create DRR in case of the issue of debentures with maturity of more than 18 months.
2. The issuer must create DRR in accordance with the provisions given below.
  - (a) If debentures are issued for project finance DRR can be created upto the date of commercial production.

- (b) The DRR in respect of debentures issued for project finance may be created either in equal installments or higher amounts if profits so permit.
- (c) In the case of PCDs, DRR must be created for the non-convertible portion of debenture issues on the same lines as applicable for fully non-convertible debenture issues.
- (d) In respect of convertible issues by new companies, the creation of DRR must commence from the year the company earns profits for the remaining life of debentures.
- (e) DRR shall be treated as part of general reserve for consideration of bonus issues proposals and for price fixation related to post-tax return.
- (f) Company must create DRR equivalent to 50% of the amount of debenture issue before debenture redemption commences. Only after the company has actually redeemed 10% of the debenture liability, withdrawal from DRR is permissible only after the company has actually redeemed 10% of the debenture liability. The requirement of creation of DRR is not applicable to the issue of debt instruments by infrastructure companies.

**Answer 2(e)****Notes to Accounts**

<b>1. Reserves and Surplus</b>		<i>(Rs. in lakh)</i>
<i>Particulars</i>	<i>Amount (Rs.)</i>	
Capital Redemption Reserve	210	
Securities premium	115	
Statement of Profit and Loss (Debit)	(118)	
<b>Total</b>	<b>207</b>	
<b>2. Non Current Liabilities</b>		<i>(Rs. in lakh)</i>
<i>Particulars</i>	<i>Amount (Rs.)</i>	
9% Debentures	400	
Term Loan	250	
Deferred tax liability	65	
<b>Total</b>	<b>715</b>	
<b>3. Current Liabilities</b>		<i>(Rs. in lakh)</i>
<i>Particulars</i>	<i>Amount (Rs.)</i>	
Unpaid Dividends	21	
Interest received in advance	10	
Loans repayable on demand	32	
<b>Total</b>	<b>63</b>	

**Answer 2A(i)**

(Rs. in lakh)

<i>S. No.</i>	<i>Particulars</i>		<i>Dr.</i>	<i>Cr.</i>
1.	Bank a/c	Dr.	2500	
	To Investment a/c			2200
	To Statement of Profit and Loss			300
	(Being investment sold for the purpose of buy-back of equity shares)			
2.	Equity share capital a/c	Dr.	1000	
	Securities premium a/c (premium payable on buyback)	Dr.	3500	
	To equity share buy-back a/c			4500
	(being the amount due on buy back of equity shares)			
3.	General reserve a/c	Dr.	1000	
	To Capital redemption reserve a/c			1000
	(Being due to buy back of shares, creation of capital redemption reserve)			
4.	Equity share buy-back a/c	Dr.	4500	
	To bank a/c			4500
	(being payment made for buy back of equity shares)			
5.	12% Debenture a/c	Dr.	180	
	To Own debenture a/c			150
	To Capital reserve a/c (Profit on cancellation)			30
	(being own debentures cancelled at profit)			

Alternatively, for entry no. 3 following entry may be passed:

Securities premium a/c	Dr.	500	
Surplus a/c	Dr.	500	
To Capital redemption reserve a/c			1000
(Being securities premium and surplus a/c utilised for creation of CRR a/c)			

**Answer 2A(ii)**

$$\begin{aligned} \text{Capital employed} &= \text{shareholders' fund} + \text{Long term debt} \\ &= \text{Rs. 4200 lakh} + \text{Rs. 1800 lakh} = \text{Rs. 6000 lakh} \end{aligned}$$

$$\text{Cost of debt after tax} = \text{Risk free rate} (1 - \text{tax rate}) = 0.10 (1 - 0.30) = 7\%;$$

$$\text{Cost of equity} = 20\%$$

Weighted average cost of capital (WACC)

Source of fund	Amount (Rs. in lakh)	Weight	Cost of capital	WACC
Equity	4200	0.70	0.20	0.14
Debt	1800	0.30	0.07	0.021
Total	6000			0.161 or 16.10%

$$\text{Net Operating profit after tax} = (\text{Net operating profit before interest and tax} - \text{Interest}) (1 - \text{tax rate})$$

$$\text{NOPAT} = (\text{Rs. 2150 lakh} - \text{Rs. 180 lakh}) (1 - 0.30) = \text{Rs. 1379 lakh}$$

Calculation of Economic value added

Particulars	Rs. in lakh
Net operating profit after tax (NOPAT)	1379
Less: cost of operating capital employed (6000 * 16.10%)	(966)
Economic value added (EVA)	<u>413</u>

**Answer 2A(iii)****(1) Calculation of Cost of Control**

Particulars	Rs. in lakh	Rs. in lakh
Cost of Investment in shares of Beta Ltd.		460
Less: Paid up share capital held	240	
Capital profit- pre-acquisition (80% of Rs. 180 lakh)	144	
Profit on revaluation of Land and Building (capital profit) (80% of Rs. 60 lakh)	48	(432)
Cost of control/ Goodwill		<u>28</u>

**(2) Computation of Minority Interest**

<i>Particulars</i>	<i>Rs. in lakh</i>
Paid up value of shares held (Rs. 300 lakh * 20%)	60
<i>Add:</i> share of pre-acquisition profit (Rs. 180 lakh * 20%)	36
<i>Add:</i> share of profit on Revaluation of Land and Building (Rs. 60 lakh * 20%)	12
<i>Add:</i> share of post acquisition profit (Rs. 250 lakh – Rs. 180 lakh – Additional Depreciation Rs. 6 lakh = Rs. 64 lakh * 20%)	12.8
Minority Interest	120.8

**Working notes:**

Profit on Revaluation and Additional depreciation

Profit on Revaluation of Land and Building = 20% of Rs. 300 lakh = Rs. 60 lakh

Additional Depreciation

Depreciation on Land and Building for 2018-19 = Rs. 300 lakh – Rs. 270 lakh  
= Rs. 30 lakh

Rate of Depreciation on land and Building =  $30/300 = 10\%$

Additional Depreciation = Rs. 60 lakh \* 10% = Rs. 6 lakh

**Question 3**

- (a) Aman Ltd. issued to the public 16,000, 10% Debentures of ₹100 each at a discount of 2%. The amount payable by applicants is as ₹50 per debenture along with application and balance amount at the time of allotment. The issue was fully underwritten by Gama Ltd. for commission at the rate of 1% of nominal value of the debentures underwritten. The whole of the issue was subscribed by the members of the public at large. The company paid underwriting commission in the form of 10% Debentures of ₹100 each.

Pass the necessary journal entries in the books of Aman Ltd. for the above mentioned transactions. (5 marks)

- (b) Following balances are provided by Nakul Ltd. for the year ended on 31st March, 2018 and on 31st March, 2019 :

<i>Particulars</i>	<i>Amount (₹ in lakh)</i>	
	<i>31st March, 2018</i>	<i>31st March, 2019</i>
<i>Equity Share Capital</i>	500	560
<i>General Reserves</i>	310	365

	11	EP-CMA-June 2019
Surplus	165	222
8% Debentures	350	200
Goodwill	60	47
Land & Building	430	387
Plant & Machinery	300	330
Investment (Trading)	48	53
Trade Payables	105	122
Provision for tax	78	98
Outstanding Expenses	18	13
Inventories	165	153
Trade Receivables	171	206
Cash at Bank	52	63
Prepaid Expenses	7	5

**Additional Information :**

- (1) During the year, an old machine costing ₹45 lakh was sold for ₹21 lakh. It's written down value was ₹29 lakh.
- (2) Depreciation charged on plant and machinery @ 15% on the opening balance.
- (3) There were no purchases or sales of land and building during the year.
- (4) Provision for tax made during the year was ₹96 lakh.
- (5) During the year, premium on redemption of debentures was written-off as ₹15 lakh.

From the above mentioned information, you are required to prepare a Statement showing the Net Cash Flow from the Operating Activities.

(5 marks)

- (c) What are the responsibilities of the Trustees of the International Financial Reporting Standards (IFRS) Foundation ? (5 marks)

**Answer 3(a)**

**Journal of Aman Ltd.**

S. No.	Particulars		Rs.	Rs.
1.	Bank a/c	Dr.	8,00,000	
	To 10% Debenture Application a/c			8,00,000
	(being receipt of application money on 16,000, 10% Debentures of Rs. 50 per debenture)			
2.	10% Debenture Application a/c	Dr.	8,00,000	
	10% Debenture Allotment a/c	Dr.	7,68,000	
	Discount of issue of Debenture a/c	Dr.	32,000	

To 10% Debenture a/c		16,00,000
(being allotment of 16,000, 10% debentures of Rs. 100 each at a discount of Rs. 2 per debenture)		
3. Underwriting commission on issue of debenture a/c	Dr. 16,000	
To Gama Ltd.		16,000
(being underwriting commission @ 1% on Rs. 16 lakh, the nominal value of debentures underwritten)		
4. Gama Ltd. a/c	Dr. 16,000	
To 10% Debentures a/c		16,000
(being allotment of 160, 10% debentures of Rs. 100 each at par to underwriters by way of payment of underwriting commission due to them)		
5. Bank a/c	Dr. 7,68,000	
To 10% Debenture allotment a/c		7,68,000
(being receipt of allotment money on 16,000, 10% debentures @ Rs. 48 per debenture)		

**Answer 3 (b)****Statement showing Net cash outflow from Operating activities for the year ending 31st March, 2019***(Rs in lakh)*

<i>Particulars</i>	<i>Rs.</i>
Surplus as on 31-3-19	222
Less: surplus as on 31-3-18	(165)
Add: Transfer to General Reserves	55
Add: provision for tax	96
Profit before taxes and extraordinary items	208
Adjustment for Depreciation:	
Land and Building (Rs. 430 – Rs. 387)	43
Plant and Machinery (15% of Rs 300)	45
Loss on sale of Plant and machinery (Rs. 29 – Rs. 21)	8
Goodwill written off (Rs. 60 – Rs. 47)	13
Premium on redemption of debenture written off	15
Operating profit before working capital changes	332

Working capital changes:	
Increase in Investment (Trading)	(5)
Decrease in prepaid expenses	2
Decrease in inventory	12
Increase in trade receivables	(35)
Increase in trade payables	17
Decrease in outstanding expenses	(5)
Cash generated from outstanding operations	<u>318</u>
Income tax paid	(76)
Net cash inflow from operating activities	<u>242</u>

*Working notes:*

**Provision for tax a/c**

*(Rs in lakh)*

Particulars	Rs.	Particulars	Rs.
To bank a/c (bal fig)	76	By balance b/d	78
To balance c/d	98	By profit ad loss a/c	96
	<u>174</u>		<u>174</u>

**Answer 3(c)**

The Trustees of the International Financial Reporting Standards (IFRS) Foundation are responsible for the governance and oversight of the International Accounting Standards Board (Board).

The Trustees are not involved in any technical matters relating to IFRS Standards. This responsibility rests solely with the Board. The Trustees are accountable to the Monitoring Board, a body of publicly accountable market authorities.

Trustees are appointed for a renewable term of three years. Each Trustee is expected to have an understanding of, and be sensitive to, international issues relevant to the success of an international organization responsible for the development of high quality global accounting standards for use in the world's capital markets and by other users.

The Trustees' responsibilities include the following but not limited to:

- appointing members of the Board, the IFRS Interpretations Committee and the IFRS Advisory Council;
- establishing and amending the operating procedures, consultative arrangements and due process for the Board, the Interpretations Committee and the Advisory Council;

- reviewing annually the strategy of the Board and assessing its effectiveness; and
- ensuring the financing of the IFRS Foundation and annually its budget approving.

In exercising their governance responsibilities, the Trustees may reconsider or amend the Board's due process or recommend, for example, improvements to the Board's outreach activities. In addition, the constitution requires the Trustees to undertake a formal, public review of the structure of the IFRS Foundation, its governance arrangements and its effectiveness in fulfilling the organization's objectives every five years.

The Trustees are accountable to a Monitoring Board of public authorities. Their reports to the Monitoring Board are available on the Trustees' meeting pages.

#### Question 4

- (a) From the following Balance Sheets of Viva Ltd. and Jiyu Ltd., prepare the Consolidated Balance Sheet in the books of Viva Ltd. Viva Ltd. acquired the shares of Jiyu Ltd. as on 1st October, 2018. Balance Sheet as at 31st March, 2019 :

Particulars	Amount (₹)	
	Viva Ltd.	Jiyu Ltd.
Share Capital	30,00,000	6,00,000
General Reserve	4,00,000	—
Profit and Loss account	6,00,000	2,10,000
Sundry creditors	5,00,000	1,90,000
Land and Building	24,00,000	4,00,000
Plant and Machinery	4,00,000	4,00,000
Current Assets	11,60,000	2,00,000
Investments (5,400 shares of ₹100 each of Jiyu Ltd.)	5,40,000	—

The profit and loss account of Jiyu Ltd. had a credit balance of ₹90,000 on 1st April, 2018. (5 marks)

- (b) Prepare a Value Added Statement for the year ended on 31st March, 2019 and also Reconciliation of Total value added with Profit before Taxes, from the Profit and Loss Statement of Fungi Ltd. :

Particulars	Amount (₹ in '000)	
Income :		
Sales	24,400	
Other Income	508	24,908
Expenditure :		
Operating cost	21,250	
GST	1,110	
Interest on Bank Overdraft	75	

<i>Interest on 9% Debentures</i>	<u>1,200</u>	23,635
<i>Profit before Depreciation</i>		1,273
<i>Depreciation</i>		<u>405</u>
<i>Profit before Tax</i>		868
<i>Provision for tax</i>		<u>320</u>
<i>Profit after Tax</i>		548
<i>Proposed dividend</i>		<u>48</u>
<i>Retained profit</i>		500

The following additional information is provided to you :

- (1) Sales represent net sales after adjusting discounts and returns.
- (2) Operating cost includes ₹ 82,50,000 as wages, salaries and other benefits to the employees.
- (3) Bank overdraft is for the temporary period only. (7 marks)

**Answer 4(a)**

**Consolidated Balance sheet of Viva Ltd. and its subsidiary Jiyu Ltd.**

<i>Particulars</i>	<i>Amount (Rs.)</i>
<b>I. EQUITY AND LIABILITIES</b>	
1. Shareholder's Fund	
(a) Share capital	30,00,000
(b) Reserves and Surplus	
Capital reserve	1,35,000
General reserve	4,00,000
Profit and Loss a/c (consolidated)	6,54,000
2. Minority Interest	81,000
3. Non-current liabilities	-
4. Current liabilities	
Trade payables	<u>6,90,000</u>
TOTAL	49,60,000
<b>II. ASSETS</b>	
1. Non-current assets	
(a) Fixed assets	
Land and building	28,00,000
Plant and machinery	8,00,000
2. Current assets	<u>13,60,000</u>
TOTAL	49,60,000

*Working notes:*

## (i) Net worth of Jiyu Ltd.

	<i>Rs.</i>
Paid up capital	6,00,000
Opening balance of P&L a/c	90,000
Pre-acquisition profit for 6 months	60,000
Net worth	<u>7,50,000</u>

## (ii) Goodwill or Capital Reserve

Cost of investments	5,40,000
Share in net worth of Jiyu Ltd. (90%)	6,75,000
Capital reserve	<u>1,35,000</u>

## (iii) Minority Shareholder's interest

Share in net worth (10%)	75,000
<i>Add</i> : post acquisition profit (60,000 * 10/100)	6,000
Minority shareholder's interest	<u>81,000</u>

## (iv) Consolidated profit

Balance of P&L a/c of Viva Ltd.	6,00,000
<i>Add</i> : share in post acquisition profit (90% of Rs. 60,000)	54,000
	<u>6,54,000</u>

**Answer 4(b)****Value added Statement of Fungi Ltd.***Rs. in '000*

<i>Particulars</i>	<i>Rs.</i>	<i>Rs.</i>
Sales		24,400
<i>Less</i> : Operating cost – cost of brought in material and services (Rs. 21,250 – 8,250)	13,000	
GST	1,110	
Interest on bank overdraft	<u>75</u>	<u>(14,185)</u>
Value added by trading and manufacturing activities		10,215
<i>Add</i> : other income		<u>508</u>

	17	EP-CMA-June 2019	
Total value added		10,723	
Application of value added			%
To pay employees:			
Wages, salaries and other benefits		8,250	76.94%
To pay Government : Corporate tax		320	2.98%
To pay provider of capital:			
Interest on 9% debentures	1200		
Dividends	<u>48</u>	1248	11.64%
To provide for maintenance and expansion of the company:			
Depreciation	405		
Retained profit	<u>500</u>	<u>905</u>	<u>8.44%</u>
		10,723	100%
Reconciliation			
Profit before tax		868	
Depreciation		405	
Wages, salaries and other benefits to employees		8,250	
Debenture interest		<u>1,200</u>	
		10,723	

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## PART II

### Question 5

(a) Following data are provided by Mahi Ltd. :

<i>Particulars</i>	<i>Product-Kau (₹)</i>	<i>Product-Vau (₹)</i>
<i>Direct material @ ₹25 per kg.</i>	<i>250</i>	<i>200</i>
<i>Direct labour @ ₹48 per hour</i>	<i>240</i>	<i>168</i>
<i>Selling Price</i>	<i>900</i>	<i>667</i>

*Variable overheads charged @ ₹30 per hour*

*Raka, Managing Director, would like to decide which product to manufacture in the following circumstances :*

- (1) *If the monsoon is not up to the mark, in such circumstances the scarcity of raw material is expected for both products.*

(2) On account of e-marketing the sales volume may be a constraint. You are required to assist him in decision making, by considering both the situations in isolation.

(b) What are the disclosure requirements as per Ind AS 102 ?

(c) From the following information, you are required to calculate the Value per Equity Share as on 1st April, 2020 of Udhami Limited :

50,00,000 Equity Shares of ₹10 each fully paid-up.

20,00,000 Equity Shares of ₹10 each, ₹6 paid-up

1,50,000, 9% Debentures of ₹100 each.

Expected profit (before interest and tax) for the year ended on 31st March, 2020: ₹228 lakh.

Expected rate of corporate tax : 31.20%

Normal rate of return on equity shares in the industry, to which the company belongs to is 15%.

(d) Explain the applicability of Cost Audit as per Rule 4 of the Companies Act, 2013. (5 marks each)

#### Answer 5(a)

	Product-Kau (Rs.)	Product-Vau (Rs.)
Direct Material @ Rs. 25 per kg	250	200
Direct labour @ Rs. 48 per hour	240	168
Variable Overheads @ Rs. 30 per hour	150	105
Variable cost per unit	640	473
Selling price per unit	900	667
Contribution per unit	260	194
P/V Ratio (Contribution/selling price)	28.89%	29.09%

(1) Direct material is the key factor

Direct material per unit for Kau =  $250/25 = 10$  kg and for Vau =  $200/25 = 8$  kg

Contribution per kg for Kau =  $\text{Rs. } 260/10 = \text{Rs. } 26$  and for Vau =  $\text{Rs. } 194/8 = \text{Rs. } 24.25$

Hence, Product Kau is recommended.

(2) Sales volume is key factor

Contribution per unit of product Kau is more than that of Product Vau. Hence, Product Kau is recommended.

**Answer 5(b)**

Ind AS 102 pertains to Accounting for share based payments and requires entities to disclose the following:

1. The type and scope of agreements existing during the reporting period.
2. Description of agreements (settlement methods, vesting conditions, etc.).
3. The number and weighted-average exercise price of share options by category (outstanding at the beginning of the reporting period and at the end of the reporting period, granted, vested, exercised and forfeited).
4. Average share price of exercised options.
5. Range of exercise prices and remaining contractual life of options outstanding at the end of the reporting period.
6. Valuation method used to estimate the fair value of the awards (model and input values, etc.).
7. The impact on the income statement (i.e., total expense) and the financial position (e.g., carrying amount of liabilities) of share-based payment awards.

**Answer 5(c)**

<i>Particulars</i>	<i>Rs. in lakhs</i>
Expected profit before interest and tax	228
Less: interest (Rs. 1,50,00,000 * 9%)	(13.50)
Profit before tax	214.50
Less: Tax @ 31.20%	(66.924)
Expected Profit available for equity shareholders	147.576

Expected rate of return = Rs. 147.576 lakh /Rs. 620 lakh = 23.80%

Value per equity shares = Expected rate of return/normal rate of return) \* paid up value

Value per equity share (Fully paid up) = (23.80/15) \* Rs. 10 = Rs. 15.87

Value per equity share (Rs. 6 paid up) = (23.80/15)\* Rs. 6 = Rs. 9.52

**Answer 5(d)**

The companies required to include cost records in their books of account in accordance with sub-rule (1) of the Companies (Cost Record and Audit) Rules, 2014, shall be required to get such cost records audited by a cost auditor.

Every company specified in item (A) of rule 3 of the Companies (Cost Record and Audit) Rules, 2014 shall get its cost records audited in accordance with these rules if the overall annual turnover of the company from all its products and services during the immediately preceding financial year is rupees fifty crore or more and the aggregate

turnover of the individual product or products or service or services for which cost records are required to be maintained under rule 3 of the Companies (Cost Record and Audit) Rules, 2014 is rupees twenty five crore or more.

Every company specified in item (B) of rule 3 of the Companies (Cost Record and Audit) Rules, 2014 shall get its cost records audited in accordance with these rules if the overall annual turnover of the company from all its products and services during the immediately preceding financial year is rupees one hundred crores or more and the aggregate turnover of the individual product or products or service or services for which cost records are required to be maintained under rule 3 is rupees thirty five crores or more.

The requirement for cost audit under these rules shall not apply to a company which is covered in rule 3; and-

- (i) whose revenue from exports, in foreign exchange, exceeds seventy five per cent of its total revenue; or
- (ii) which is operating from a special economic zone;
- (iii) which is engaged in generation of electricity for captive consumption through Captive Generating Plant. For this purpose, the term "Captive Generating Plant" shall have the same meaning as assigned in rule 3 of the Electricity Rules, 2005". Even for regulated sectors like Telecommunication, Electricity, Petroleum and Gas, Drugs and Pharma, Fertilizers and Sugar cost audit requirement has been made subject to a turnover based threshold of Rs. 50 crores for all product and services and Rs. 25 crores for individual product or services. For non-regulated sector the threshold is Rs. 100 crores and Rs. 35 crores, respectively.

**Attempt all parts of either Q. No. 6 or Q. No. 6A**

**Question 6**

- (a) The following details are provided by Trupti Engineering Ltd. with respect to their product, named as Prima :

Level of activity (Units)	1,000	2,000
Cost per unit (₹)		
Direct materials	4.00	4.00
Direct labour	3.00	3.00
Production overheads	3.50	2.50
Selling overheads	1.00	0.50
Total	11.50	10.00

You are required to compute the total fixed cost of Trupti Engineering Ltd. and also variable cost per unit of the product Prima. (5 marks)

- (b) Explain the components of the total risk of a security. Provide necessary examples for each component of risks. (5 marks)

- (c) What do you understand by Shareholder Value Added (SVA) ? What are the benefits of adopting SVA ? (5 marks)
- (d) You have applied for the position of Assistant Company Secretary in Sashvati Ltd. As part of the pre-interview scanning, the following information has been provided to you :

Sales	₹1,825 lakh
Net Worth to Sales	90%
Current Liabilities to Net Worth	20%
Total Debt to Net Worth	50%
Receivables average collection period	44 Days
Inventory Turnover (Based on Cost of Goods Sold)	4.839 Times
Number of days in a year	365
Ratio of inventory, receivables and cash & bank balance in current assets	3:2:1
Cash sales are 1/4th of credit sales	

As part of scanning exercise, you are required to calculate and inform to the interviewer, following values :

- (1) Non-current debt (as per the Companies Act, 2013),
- (2) Receivables,
- (3) Current assets, and
- (4) Cost of goods sold. (5 marks)

**OR (Alternate question to Q. No. 6)**

**Question 6A**

- (i) Roma Ltd. has to choose one of the machines from two mutually exclusive machines.

Two proposals are : Machine Rani and Machine Prince. The required amount of cash outlays for Machine Rani is ₹8,35,000; while for Machine Prince is ₹9,00,000. The current rate of yield on Government of India's bond is 7%, and the management is of the opinion to use the same as discount rate. The expected net cash inflows by deployment of both the machines are as under :

Year end	Amount (₹)	
	Machine Rani	Machine Prince
1	3,60,000	4,05,000
2	3,50,000	3,60,000
3	2,50,000	3,50,000

You have to advise the management with respect to selection of either Machine Rani or Machine Prince. The Present value interest factor for the year 1, 2 and 3 are 0.9346, 0.8734 and 0.8163 respectively, for 7% discount rate. (5 marks)

(ii) The following information is provided by Muni Ltd. :

Sales Budget for the year 1<sup>st</sup> April, 2019 to 31<sup>st</sup> March, 2020

Quarter	Product-Pixel (units)	Product-Quita (units)
1st Quarter	25,000	23,000
2nd Quarter	30,000	25,000
3rd Quarter	40,000	32,000
4th Quarter	48,000	40,000

The additional information is provided with respect to inventory management as under :

- (1) Expected stock position as on 1<sup>st</sup> April, 2019 : Product Pixel and Quita as 25% and 80% of expected sales of 1<sup>st</sup> Quarter of the next financial year respectively.
- (2) Expected stock position at the end of 1<sup>st</sup>, 2<sup>nd</sup> and 3<sup>rd</sup> Quarter will be 25% of next Quarter's sales for both the products — Pixel and Quita.
- (3) Expected stock position as on 31<sup>st</sup> March, 2020 will be : Product Pixel — 28,000 units and Product Quita — 15,000 units.

You are required to prepare Quarter-wise Production Budget for the year 2019-20, for both the products separately. (5 marks)

(iii) What are the essential steps to be taken to have an effective management reporting system in the firm ? (5 marks)

(iv) Calculate the Weighted Average Cost of Capital of Makkhu Ltd. from the following information :

Particulars	Amount in ₹
4,00,000 Equity Shares of ₹10 each fully paid-up	40,00,000
80,000, 9% Preference Shares of ₹10 each fully paid-up	8,00,000
Retained Earnings	32,00,000
20,000, 8% Debentures of ₹100 each	20,00,000
Market price of Equity shares	45
Average Earning per share of last three years	9
Corporate Income tax rate applicable to Makkhu Ltd.	30%
Cost of Equity can be considered as Cost of Retained Earnings.	(5 marks)

**Answer 6(a)**

$$\text{Variable production overhead per unit} = \frac{(2000 \times 2.50) - (1000 \times 3.50)}{2000 - 1000} = \text{Rs. } 1.50 \text{ per unit}$$

$$\text{Fixed production overheads} = (1000 \times 3.50) - (1000 \times 1.50) = \text{Rs. } 2000$$

$$\text{Fixed selling overheads} = 1000 \times 1 = \text{Rs. } 1000$$

Hence, total variable cost per unit = Rs. 4 + Rs. 3 + Rs. 1.50 = Rs. 8.50 per unit  
and Total Fixed cost = Rs. 2000 + Rs. 1000 = Rs. 3000

**Answer 6(b)**

Total risk of a security comprises two components:

**(i) Systematic Risk or Non-Diversifiable Risk**

Systematic risk is the risk which is caused by factors beyond the control of specific company, such as general factors in the market, GDP, inflation, interest rates, tax policy, government policy, etc. These factors affect all the companies and cause variability in their returns. Systematic risk cannot be reduced by holding an efficiently diversified portfolio. Therefore, systematic risk is that part of total risk which cannot be eliminated by diversification. However, the systematic risk may be managed by ensuring that the portfolio includes a variety asset classes, like fixed income, cash and real estate, each of which will react differently in the event of a major systemic change.

Systematic risk of a security is indicated by beta coefficient ( $\beta$ ).  $\beta$  captures the sensitivity of a security's return with respect to market return.

**(ii) Unsystematic Risk or Diversifiable Risk**

It is that part of total risk which is diversifiable. It is caused by factors which are within the control of a specific company, such as management, operational efficiency, labour conditions and financial leverage. The sources of unsystematic risk are business risk and financial risk. Securities which are less than perfectly and positively correlated can be combined together to diversify away unsystematic risk.

It can be observed that unsystematic risk can be reduced to zero in an efficiently diversified portfolio; hence the only relevant risk in such a portfolio is systematic risk.

As per CAPM there is a linear and positive relationship between expected return and systematic risk measured by  $\beta$ . CAPM is used to estimate expected return from a security or portfolio.  $\beta$  measures the sensitivity of a security's returns to the return of market portfolio. Some securities are less sensitive while others are more. Hence  $\beta$  of different securities and portfolios are also different. Moreover, unsystematic risk of a security can be diversified away, hence investor will not receive any return or risk premium for bearing unsystematic risk. The investor will receive risk premium only for the systematic risk identified by  $\beta$ .

**Answer 6(c)**

Shareholder Value Added (SVA) represents the economic profits generated by a business above and beyond the minimum return required by all providers of capital. "Value" is added when the overall net economic cash flow of the business exceeds the economic cost of all the capital employed to produce the operating profit.

Therefore, SVA integrates financial statements of the business (profit and loss, balance sheet and cash flow) into one meaningful measure.

The SVA approach is a methodology which recognizes that equity holders as well as debt financiers need to be compensated for the bearing of investment risk. The SVA methodology is a highly flexible approach to assist management in the decision-making process. Its applications include performance monitoring, capital budgeting, output pricing and market valuation of the entity.

The benefits of moving towards SVA include:

1. Overall, value-based performance measures will result in greater accountability for the investment of new capital, as well as for the use of existing investments.
2. Organization will have the opportunity to apply a meaningful private sector benchmark to evaluate performance.
3. Managers will be provided with an improved focus on maximizing shareholder value.

**Answer 6(d)****(1) Non-current Debt**

Net worth = 90% of sales of Rs. 1825 lakh = Rs. 1642.50 lakh

Current liabilities = 20% of the Net worth of Rs. 1642.50 lakh = Rs. 328.50 lakh

Total debt = 50% of Net worth of Rs. 1642.50 lakh = Rs. 821.25 lakh

Hence, Non current debt = Rs. 821.25 lakh – Rs. 328.50 lakh = Rs. 492.75 lakh

**(2) Receivables**

Collection period = (Receivables \* 365) / Credit sales

or Receivables = (Collection period \* Credit sales) / 365 = (44 \* Rs. 1460 lakh) / 365

= Rs. 176 lakh

Note : Credit sales = Total sales \* 100/125 = Rs. 1460 lakh

**(3) Current assets**

Current assets = Receivables \* 6/2 = Rs. 176 lakh \* 6/2 = Rs. 528 lakh

**(4) Cost of goods sold**

Cost of goods sold = Inventory \* inventory turnover

= (Rs. 528 lakh \* 3/6) \* 4.839 = Rs. 1277.496 lakh

**Answer 6A(i)****Appraisal of machines****Machine Rani**

<i>Year end</i>	<i>Cash flow (Rs.)</i>	<i>P.V. Factor @ 7%</i>	<i>P.V. (Rs.)</i>
1	3,60,000	0.9346	3,36,456
2	3,50,000	0.8734	3,05,690
3	2,50,000	0.8163	2,04,075
			8,46,221
		<i>Less : cash outlay</i>	(8,35,000)
		<b>NPV</b>	<b>11,221</b>

**Machine Prince**

<i>Year end</i>	<i>Cash flow (Rs.)</i>	<i>P.V. Factor @ 7%</i>	<i>P.V. (Rs.)</i>
1	4,05,000	0.9346	3,78,513
2	3,60,000	0.8734	3,14,424
3	3,50,000	0.8163	2,85,705
			9,78,642
		<i>Less : cash outlay</i>	(9,00,000)
		<b>NPV</b>	<b>78,642</b>

*Decision* : as the NPV of Machine Prince is higher, therefore Machine Prince is Preferable.

**Answer 6A(ii)****Production Budget for year 2019-20***Product Pixel**(Amount in Rs.)*

<i>Particulars</i>	<i>1st quarter</i>	<i>2nd quarter</i>	<i>3rd quarter</i>	<i>4th quarter</i>
Budget sales	25,000	30,000	40,000	48,000
Add : closing stock	7500	10,000	12,000	28,000
	32,500	40,000	52,000	76,000
Less : opening stock	(6250)	(7500)	(10,000)	(12,000)
<b>Budgeted production</b>	<b>26,250</b>	<b>32,500</b>	<b>42,000</b>	<b>64,000</b>

*Product Quota**(Amount in Rs.)*

<i>Particulars</i>	<i>1st quarter</i>	<i>2nd quarter</i>	<i>3rd quarter</i>	<i>4th quarter</i>
Budget sales	23,000	25,000	32,000	40,000
Add: closing stock	6250	8,000	10,000	15,000
	29,250	33,000	42,000	55,000
Less : opening stock	(18,400)	(6,250)	(8,000)	(10,000)
Budgeted production	10,850	26,750	34,000	45,000

**Answer 6A(iii)**

Steps towards implementing an effective management reporting system in the firm are:

- 1. Discovery** : Early identification and involvement by shareholders, and effectively communicate the vision across the organization and to the appropriate stakeholders. Identify and access the data sources available to meet the specific data needs.
- 2. Analysis** : Understand the level of effort involved in creating each report. Develop data definitions to ensure everyone interprets it the same way. Keep the data tight and prioritize the information, and understand what the data says. Further, encourage quick decision making abilities of the recipient.
- 3. Report creation and delivery** : Create the reports and determine the appropriate delivery method of the data. Reports should be concise and comprehensive, but not overwhelming. Pay close attention while formatting and reporting, considering the specific needs of the users.
- 4. Implementation** : Develop each report separately, and establish a governance process and policies to ensure data health across the organization. Define access control requirements, detailing who should have rights to access information. Minimize work by leveraging implemented software to create repeatable processes and automate report jobs for predetermined times throughout the month.
- 5. Access point** : Create a common place for users to access data, such as a Web portal or SharePoint site.
- 6. Feedback** : Collect comments and suggestions from users to discover ways to continuously improve the data and process.
- 7. In-house IT capabilities** : Ensure that in-house Information Technology (IT) personnel can manage necessary systems and issues if they arise.

**Answer 6A(iv)**

$$\text{Cost of equity (Ke)} = (\text{EPS/MPS}) \times 100 = (9/45) \times 100 = 20\%$$

$$\text{Cost of Preference shares (Kp)} = 9\%$$

Cost of retained earnings (Kr) = 20%

Cost of Debt (Kd) =  $r(1-t) = 8(1-0.30) = 5.6\%$

**Calculation of WACC**

<i>Source of Funds</i>	<i>Amount (Rs.)</i>	<i>Weight</i>	<i>Cost of capital</i>	<i>WACC</i>
Equity shares	40,00,000	0.4	0.20	0.08
Preference shares	8,00,000	0.08	0.09	0.0072
Retained earnings	32,00,000	0.32	0.20	0.064
Debentures	20,00,000	0.20	0.056	0.0112
Total	<u>1,00,00,000</u>			<u>0.1624 or 16.24%</u>

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## SECURITIES LAWS & CAPITAL MARKETS

Time allowed : 3 hours

Maximum marks : 100

**NOTE :** Answer **ALL** Questions.

### PART I

#### Question 1

- (a) A Mutual Fund having 300 units has shown Net Asset Value (NAV) of ₹8.75 and ₹9.45 at the beginning and at the end of the year respectively. The Mutual Fund has given two options :
- (i) Pay ₹ 0.75 per unit as dividend and ₹0.60 per unit as capital appreciation; or
- (ii) These distributions are to be reinvested at an average NAV of ₹8.65 per unit
- What difference it would make in terms of return available and which option is preferable ?
- (b) 'A stock exchange on its own can delist any security thereon'. Explain how Recognized Stock Exchange delists any securities listed thereon under Securities Contracts (Regulations) Rules, 1957.
- (c) Your Board of directors is contemplating to take-up the agenda to issue ESOS in next meeting. Being a Company Secretary, advise your Board of directors about brief procedure for issuing of securities under SEBI Employees Stock Option Scheme (ESOS) by a listed Company.
- (d) Can a Company buy-back its own shares or any specified securities through negotiated deals or through any private arrangements ? Comment with methods allowed for buy-back. (5 marks each)

#### Answer 1(a)

##### Basic data for Computation

Opening NAV	Rs. 8.75
Closing NAV	Rs. 9.45
Dividend	Rs. 0.75
Capital gain appreciation [Closing NAV- Opening NAV]	Rs. 0.70
Capital gain distribution	Rs. 0.60
Price paid at the year beginning [300 units x Rs. 8.75]	Rs. 2,625

**Option I: Returns are distributed to Mutual Fund Holders****Total Fund Assets:**

NAV on closing date [9.45 x 300]	Rs. 2,835
Dividend payable [0.75 x 300]	Rs. 225
Capital gain distribution [0.60 x 300]	Rs. 180
	Rs. 3,240

Returns :  $(Rs. 3,240 - Rs. 2,625) / Rs. 2,625 = 23.43\%$

**OR****Alternate Answer****Option I: When Dividend and Capital Gain are paid:**

Calculation of monthly return on the mutual funds:

$$r = \frac{NAV_1 - NAV_{t-1} + I_t + G_t}{NAV_{t-1}}$$

$$\text{Or, } r = \frac{Rs. 9.45 - Rs. 8.75 + (Rs. 0.75 + Rs. 0.60)}{Rs. 8.75}$$

$$= \frac{0.70 + 1.35}{8.75} = 23.43\%$$

**Option II: The distributions are reinvested at an average NAV of Rs. 8.65 per unit****(i) Distribution reinvested**

Capital gain [Rs. 0.60 x 300]	Rs. 180
Dividend [Rs. 0.75 x 300]	Rs. 225
Total Distribution	Rs. 405

No. of units [Total distributions ÷ Average NAV per unit = Rs. 405 ÷ Rs. 8.65]  
46.82

**(ii) Preparation of fund position**

NAV on closing date fund assets

- 300 units @ Rs. 9.45	Rs. 2,835.00
- 46.82 units @ Rs. 9.45	Rs. 442.45
	<u>Rs. 3,277.45</u>

Returns:  $(3,277.45 - 2,625) / 2625 = 24.85\%$

**OR**

**Alternate Answer**

**Option II: When Dividend and Capital Gain are reinvested:**

If all dividends and capital gain are reinvested into additional units at Rs. 8.65 per unit the position would be.

Total amount reinvested = Rs. 1.35 x 300 = Rs.405

Additional units added = Rs.  $\frac{405}{8.65}$  = 46.82 units or 47 units

Value of units at the end = 346.82 units x Rs. 9.45 = Rs. 3, 277.45

Or = 347 units x Rs. 9.45 = Rs.3, 279.15

Price paid for 300 units as at the beginning = (300 x Rs. 8.75) = Rs. 2,625

Return = (Rs. 3, 277.45 – Rs. 2, 625)/ Rs. 2, 625 = 24.86%

Or Return =  $\frac{\text{Rs. } 3, 279.15 - \text{Rs. } 2, 625}{\text{Rs. } 2, 625} = \frac{\text{Rs. } 654.15}{\text{Rs. } 2, 625} = 24.92\%$

**Conclusion:** From the above, it can be said that reinvestment option is better as it yield higher return by 1.49%.

**Answer 1(b)**

Rule 21 of the Securities Contracts (Regulations) Rules, 1957 deals with the delisting of securities. A recognized stock exchange may, without prejudice to any other action that may be taken under the Act or under any other law for the time being in force, delist any securities listed thereon on any of the following grounds in accordance with the regulations made by the Securities and Exchange Board of India, namely:—

- (a) the company has incurred losses during the preceding three consecutive years and it has negative networth;
- (b) trading in the securities of the company has remained suspended for a period of more than six months;
- (c) the securities of the company have remained infrequently traded during the preceding three years;
- (d) the company or any of its promoters or any of its director has been convicted for failure to comply with any of the provisions of the Act or the Securities and Exchange Board of India Act, 1992 or the Depositories Act, 1996 or rules, regulations, agreements made thereunder, as the case may be and awarded a penalty of not less than rupees one crore or imprisonment of not less than three years;
- (e) the addresses of the company or any of its promoter or any of its directors, are not known or false addresses have been furnished or the company has changed its registered office in contravention of the provisions of the Companies Act, 2013;
- (f) shareholding of the company held by the public has come below the minimum

level applicable to the company as per the listing agreement under the Act and the company has failed to raise public holding to the required level within the time specified by the recognized stock exchange. No securities shall be delisted unless the company concerned has been given a reasonable opportunity of being heard.

**Answer 1(c)**

To

The Board of Directors

*Sub: Procedure for issuing securities under SEBI (Share Based Employee Benefits) Regulations, 2014*

As it has been decided by the Board of Directors (BoD), to issue employee stock option, to take up as an agenda in the next meeting of the BoD, the following is the procedure for issuing ESOP by a Listed Company:

- Hold a Board Meeting to consider and approve ESOP and formation of Compensation Committee;
- Compensation committee shall plan draft the scheme of ESOP;
- Hold Board meeting to adopt the final scheme, appoint a registered Merchant banker and approve the notice of the General meeting for shareholders' approval by passing special resolution;
- Hold General Meeting for approval of shareholders;
- Make an application to the stock exchange for obtaining in-principal approval for listing of proposed ESOP shares;
- Issue letter of grant of option to the eligible employees along with the letter of acceptance of option;
- If the grant is made to NRI employees, comply with norms of RBI as per FDI Policy.
- On receipt of letter of acceptance of option along with upfront payment (if any), from the employee issue the option certificates;
- There shall be a minimum vesting period of one year and after expiry of vesting period, the company shall issue a letter of vesting along with the letter of exercise of options;
- Receipt to letter of exercise from the employee;
- Hold a Board Meeting at the suitable Interval during the exercise period for allotment of shares on options exercised by the Employees;
- Dispatch of letter of allotment along with the share certificates or credit the shares so allotted with the Depositories;
- Make an application to the Stock exchange for listing of the Shares so allotted; and
- Receipt of listing approval from the Stock Exchange(s).

**Mr X**

**Company Secretary**

*Note : Notice of Meetings (both Board & Shareholder) has to be given.*

*For Board Meetings : atleast 7 days notice.*

*For Shareholder meeting : atleast 21 days notice.*

**Answer 1(d)**

As per Regulation 4 (vi) of the SEBI (Buy-back of Securities) Regulations, 2018, a company shall not buy-back its shares or other specified securities from any person through negotiated deals, whether on or off the stock exchange or through spot transactions or through any private arrangement.

As per Regulation 4 (iv) of the SEBI (Buy-back of Securities) Regulations, 2018, a company may buy-back its shares or other specified securities by any one of the following methods:

- (a) from the existing shareholders or other specified securities holders on a proportionate basis through the tender offer;
- (b) from the open market through —
  - (i) book-building process,
  - (ii) stock exchange;
- (c) from odd-lot holders.

**Attempt all parts of either Q. No. 2 or Q. No. 2A**

**Question 2**

- (a) *A listed company can apply to stock exchange for re-classification of the Promoter's holdings as public shareholders under SEBI regulations. Whether following promoters can apply for re-classification with reference to SEBI regulations ?*
  - (a) *Promoter is declared as willful defaulter as per RBI guidelines.*
  - (b) *Promoter is holding 12% of total voting rights in the listed entity.*
  - (c) *Promoter is acting as CEO of the listed entity.*
  - (d) *The promoter company has outstanding listing fees only for one year.*
- (b) *Explain the Modes of Payment to the shareholders of the Target Company on acquisition of shares by the acquirer under SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.*
- (c) *An acquirer, holding 25% or more but less than maximum permissible non-public shareholding of the Target Company can acquire such additional shares as would entitle him to exercise more than 5% of the voting rights in any financial year. Explain the statement indicating the creeping acquisition limit for making an open offer by an acquirer.*
- (d) *SEBI has been given necessary autonomy and authority to regulate and develop an orderly market. Elucidate the statement in the light of statutory powers vested with SEBI.*
- (e) *Life-Changing Assets Management Ltd., a mutual funds company desires to engage a bollywood celebrity to popularize its schemes. Explain the SEBI provisions with regard to celebrity endorsements of Mutual Funds at industry level.*

**OR (Alternate question to Q. No. 2)****Question 2A**

(i) M/s Highspeed Ltd. manufacturing a car components for leading car manufacturer. Its public issue of ₹500 crore was fully subscribed. The public issue money ought to be utilized for setup an assembly-line for the existing business. Out of ₹500 crore, the company spent ₹400 crore for assembly-line. The management consultant, hired for Business Process re-engineering has suggested to invest balance amount to setup bike components manufacturing unit. You, being company secretary of the company, advise on the opinion of management consultant by referring provisions of SEBI Guidelines. (4 marks)

(ii) From the following information, calculate the Enterprise Value of E Ltd. :

*Balance Sheet of E Ltd. as on 31st March, 2018*

Liabilities	Amount (₹ Lakh)	Assets	Amount (₹ Lakh)
Share Capital (Face Value ₹2)	952	Non-Current Assets	2,550
Reserves & Surplus	48	Current Assets :	
Minority Interest	115	Cash & Cash Equivalent	102
Short-term Borrowings	2,860	Other Current Assets	1,323
	3,975		3,975

Current Market Price Per Share is ₹96. (4 marks)

(iii) The Board of directors of a listed company desires to delist its equity shares from all the recognised stock exchanges. The voting details through postal ballot are as under :

— Total nos. of voters : 7,000 (Public : 5,000 & Promoters : 2,000)

— Voting at shareholders meeting :

(a) Public shareholders :

In favour : 3,300 votes

In against : 1,700 votes

(b) All promoters shareholders have voted in favour of resolution.

By referring SEBI delisting regulation, decide upon the resolution passed by the shareholders. (4 marks)

(iv) The financial data of a listed company as on 31st March, 2018 are as follows :

Authorized equity share capital ₹10 crore

(1 crore shares of ₹10 each)

<i>Paid-up equity share capital</i>	<i>₹ 5 crore</i>
<i>General reserve</i>	<i>₹ 3 crore</i>
<i>Debenture redemption reserve</i>	<i>₹ 2 crore</i>

*The Board of directors of your company passed resolution by circulation for buy-back of shares to the extent of 9% of the company's paid-up share capital and free reserves. You are required to examine the validity of the proposal with reference to the provisions of the SEBI Regulations. (4 marks)*

- (v) *Z Ltd. has issued Sweat Equity Shares for a non-cash consideration. What are the possible accounting treatments in the books of Z Ltd. ? (4 marks)*

### **Answer 2(a)**

Regulation 31A of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (“SEBI LODR Regulations”) deals with the conditions for re-classification of any person as promoter / public.

Based on the provisions of Regulation 31A of the SEBI LODR Regulations, the following are the answers to the circumstances given:

- Promoter is declared as wilful defaulter as per RBI guidelines. As per Regulation 31A (b)(vi), the Promoter declared as a ‘wilful defaulter’ as per the Reserve Bank of India Guidelines is not eligible to apply for re-classification themselves as public shareholders.
- Promoter is holding 12 % of total voting rights in the listed entity. As per Regulation 31A (b)(i), if the promoter holds more than 10% of the total voting rights in the listed entity, they are not eligible for re-classification. Hence in this case, the promoter is not eligible to apply for re-classification.
- As per Regulation 31A (b)(v), if the promoter acts as a key managerial person in the listed entity he is not eligible for re-classification. In the given case, the promoter is a CEO hence he is not eligible for re-classification
- As per Regulation 31A (c)(iii), the listed entity shall not have any outstanding dues to the SEBI, the stock exchanges or the depositories to be is eligible to apply for reclassification. In this case, the promoter company has outstanding listing fees for one year, hence it is not eligible for re-classification.

### **Answer 2(b)**

As per regulation 9 of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, the offer price may be paid, —

- in cash;
- by issue, exchange or transfer of listed shares in the equity share capital of the acquirer or of any person acting in concert;
- by issue, exchange or transfer of listed secured debt instruments issued by the acquirer or any person acting in concert with a rating not inferior to investment grade as rated by a credit rating agency registered with the SEBI;

- (d) by issue, exchange or transfer of convertible debt securities entitling the holder thereof to acquire listed shares in the equity share capital of the acquirer or of any person acting in concert; or
- (e) a combination of the mode of payment of consideration stated in clause (a), clause (b), clause (c) and clause (d).

### Answer 2(c)

As per Regulation 3 (2) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, an acquirer who holds 25% or more but less than maximum permissible non-public shareholding of the Target Company, can acquire such additional shares as would entitle him to exercise more than 5% of the voting rights in any financial year ending March 31 only after making a Public Announcement to acquire minimum twenty six percent shares of Target Company from the shareholders through an Open Offer.

- An acquirer can, who has reached at a level of 25% or more and made detailed public statement to acquire = 26% shares, received in this process.
- Then acquirer in any financial year cannot take > 5% share.
- If acquirer wants to acquire > 5% share in one FY, again public offer shall be made to receive 26% (or) more shares subject to delisting level.

Example		Acquirer holding	25% ( public offer of 26%)
		Shares acquired through public offer	22%
			4.7% + 26%
			73%
Share acquired in FY 1		5%	5%
Share acquired in FY 2	→	5%	52%
Share acquired in FY 3	→	5%	26%
Share acquired in FY 4	→	5%	78%
Share acquired in FY 5	→	5%	75-52=23%
Share acquired in FY 6	→	3%	72%
			75%

### Answer 2(d)

With regulatory jurisdiction extended over the corporates with respect to issue of capital and transfer of securities, in addition to all intermediaries and persons associated with securities market, SEBI is vested with following statutory powers:

1. protecting the interests of investors in securities,
2. promoting the development of the securities market, and
3. regulating the securities market.

Its regulatory jurisdiction extends over corporates in the issuance of capital and transfer of securities, in addition to all intermediaries and persons associated with securities market. SEBI can:

- specify the matters to be disclosed and the standards of disclosure required for the protection of investors in respect of issues;
- issue directions to all intermediaries and other persons associated with the securities market in the interest of investors or of orderly development for securities market; and
- conduct enquiries, audits and inspection of all concerned and adjudicate offences under the Act.

In short, it has been given necessary autonomy and authority to regulate and develop an orderly securities market.

#### **Answer 2(e)**

SEBI vide its Circular No. CIR/IMD/DF/23/2017 dated 15/03/2017 reviewed the advertisement guidelines for mutual funds.

In this respect, it has been decided to permit celebrity endorsements at industry level, for the purpose of increasing awareness of Mutual Funds as a financial product category. However, such celebrity endorsements of Mutual Funds at industry level, shall be subject to the following conditions:

- i. Celebrity endorsement shall be allowed only at the industry level, for the purpose of increasing awareness of Mutual Funds as a financial product category. Such celebrity endorsements should not promote a scheme of a particular Mutual Fund or be used as a branding exercise of a Mutual Fund house.
- ii. Expenses towards such celebrity endorsements for increasing awareness of Mutual Funds shall be limited to the amounts that are aggregated by Mutual Funds at industry level for the purpose of conducting investor education and awareness initiatives, in terms of clause F of SEBI circular dated September 13, 2012.
- iii. Prior approval of SEBI shall be required for issuance of any endorsement of Mutual Funds as a financial product, which features a celebrity for the purpose of increasing awareness of Mutual Funds.

#### **Answer 2A(i)**

According to the Regulation 59 of the SEBI (ICDR) Regulations, 2018, the promoters, or shareholders in control of an issuer, shall provide an exit offer to dissenting shareholders as provided for in the Companies Act, 2013, in case of change in objects or variation in the terms of contract related to objects referred to in the offer document as per conditions and manner as provided in Schedule XX of the SEBI (ICDR) Regulations, 2018.

According to the Schedule XX, the promoter or the shareholders in control, as the case may be, shall make an exit offer in accordance with the provisions of Chapter II of SEBI (ICDR) Regulations to the dissenting shareholders, in cases only if a public issue has opened after April 1, 2014; if:

- (a) The proposal for change in objects or variation in terms of a contract, referred to

in the offer document is dissented by atleast ten percent of the shareholders who voted in the general meeting; and

- (b) The amount to be utilized for the objects for which the offer document was issued is less than seventy five percent of the amount raised (including the amount for general corporate purposes as disclosed in the offer document).

In the given problem M/s Highspeed Ltd. has utilized Rs. 400 crore out of total Rs. 500 crore raised through public issue. As the amount utilized is more than 75% of the total amount raised, the company may utilize the remaining unutilized 100 crore for the purpose as stated in the question.

**Answer 2A(ii)**

Enterprise Value	=	Market Capitalisation + Debt + Minority Interest and Preferred Shares - Total Cash and Cash Equivalent
No. of shares	=	952 Lakh/ 2 = 476 Lakh
Enterprise Value	=	96 x 476 Lakhs + 115 Lakhs +2,860 Lakhs -102 Lakhs = Rs. 48,569 Lakhs

**Answer 2A(iii)**

Regulation 6 of the SEBI (Delisting of Equity Shares) Regulations, 2009, prescribed that if a company proposes to delist its equity shares from all the recognized stock exchanges where they are listed, it is required to obtain the prior approval of shareholders of the company by special resolution passed through postal ballot, after disclosure of all material facts in the explanatory statement sent to the shareholders in relation to such resolution. However, the special resolution shall be acted upon if and only if the votes cast by public shareholders in favour of the proposal amount to at least two times the number of votes cast by public shareholders against it.

In the mentioned case, the resolution was passed as special resolution as it has approval of 75% of the shareholders, however, the resolution does not have requisite approval of public shareholders. The votes cast in favour of resolution (3300 votes) is not the twice of the votes cast against the resolution (1700 votes) by the public shareholders. Therefore, the special resolution cannot be acted upon by the company.

**Answer 2A(iv)**

The financial data of a listed company as on 31st March, 2018 are as follows:

Authorized equity share capital (1 crore shares of Rs. 10 each)	Rs. 10 crores
Paid-up equity share capital	Rs. 5 crores
General reserve	Rs. 3 crores
Debenture redemption reserve	Rs. 2 crores

According to the regulation 5 of the SEBI (Buy-back of Securities) Regulations, 2018, the company shall not authorize any buy-back (whether by way of tender offer or

from open market or odd lot) unless a special resolution has been passed at a general meeting of the company authorising the buy-back. However, special resolution is not required, where the buy-back is, ten per cent or less of the total paid-up equity capital and free reserves of the company; and such buy-back has been authorised by the board of directors by means of a resolution passed at its meeting.

In the given case, the company desired to buy-back of shares to the extent of 9% of paid-up capital and free reserves by way of passing of board resolution through circulation, however as per above regulations, the board resolution should be passed at its meeting not through circulation. Therefore with reference to the above stated provisions, the proposal of buy-back is not valid.

### **Answer 2A(v)**

As per regulation 9 of the SEBI (Issue of Sweat Equity) Regulations, 2002, where the sweat equity shares are issued for a non-cash consideration, such non-cash consideration shall be treated in the following manner in the books of account of the company: -

1. where the non-cash consideration takes the form of a depreciable or amortizable asset, it shall be carried to the balance sheet of the company in accordance with the relevant accounting standards; or
2. where the above clause is not applicable, it shall be treated as expense as provided in the relevant accounting standards.

### **Question 3**

- (a) *A listed NBFC has been granted licence to run as small finance bank by the Reserve Bank of India under recently announced policy to improve the financial inclusion of the country. During the last three years, the attrition rate for top level management employees was not too high As, RBI has granted licences to many small banks, therefore, the promoters of the Bank feels that attrition rate will be high in coming . period. The Board of directors wishes to allot Sweat Equity shares to employees. You, being compliance officer of the Bank, advise the Board about pricing of the Sweat Equity shares.*
- (b) *An unlisted public company ("Acquirer") doing business of exporting steel and it is a part of the Promoter Group of Maurya Hotels (India) Ltd. (MHIL), a company listed on stock exchange. In view of improving its efficiency, MHIL is planning to restructure its group. The Acquirer has agreed to enter into a scheme of arrangement where the shares held by the promoter group companies (eight companies) will be transferred to it. Post-merger, the shareholding of the Acquirer in the Company will increase from 2% to 24%. However, the overall promoter shareholding will remain unchanged. You, being practicing company secretary, appointed as consultant by the Acquirer, answer the following :*
  - (i) *Will the transfer of shares trigger an obligation to make an open offer under the SEBI (SAST) Regulations on the Acquirer ?*
  - (ii) *What are the disclosure requirements under the SAST Regulations, if any, that the parties to the scheme will have to comply with ?*

- (c) Explain what is Informal Guidance under SEBI (Informal Guidance) Scheme, 2013 and who can seek guidance from SEBI ? (5 marks each)

**Answer 3(a)**

To

The Board of Directors

**Sub: Pricing of the Sweat Equity Shares**

As the Board of the Directors has decided to allot sweat equity shares to employees, the following are the provisions relating to pricing of sweat equity shares:

1. According to the regulation 7 of the SEBI (Issue of Sweat Equity) Regulations, 2002, the price of sweat equity shares shall not be less than the higher of the following:
  - (a) the average of the weekly high and low of the closing prices of the related equity shares during last six months preceding the relevant date; or
  - (b) the average of the weekly high and low of the closing prices of the related equity shares during the two weeks preceding the relevant date.
2. If the shares are listed on more than one stock exchange, but quoted only on one stock exchange on given date, then the price on the stock exchange shall be considered.
3. If the share price is quoted on more than one stock exchange, then the stock exchange where there is highest trading volume during that date shall be considered.
4. If the shares are not quoted on the given date, then the share price on the next trading day shall be considered.

**Answer 3(b)**

- (i) Regulations 3, 4 and 5 of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 set out the events that trigger an obligation to make an open offer on the acquirer (along with persons acting in concert). The said triggers points are as follows:
  - Acquisition (directly or indirectly) of such shares or voting rights in an Indian listed company whereby the acquirer becomes entitled to exercise 25% or more of the voting rights in such Indian listed company;
  - Where an acquirer (along with persons acting in concert with him) is already entitled to exercise 25% or more of the voting rights in an Indian listed company, and acquires (directly or indirectly) additional shares or voting rights entitling an acquirer to exercise more than 5% voting rights in an Indian listed company, in a financial year; and
  - Acquisition (directly or indirectly) of control.

Since the Acquirer, in the above facts, does not attract any of the triggers set

out above, the transfer of shares will not impose any obligation on the Acquirer to make an open offer under the SEBI (SAST) Regulations.

- (ii) The Acquirer and promoter group companies will be required to make a disclosure of change in shareholding under Regulation 29(2) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011. According to Regulation 29(3) of the said regulations, the disclosure should be made within 2 working days of such acquisition or the disposal to the target company at its registered office and to the stock exchanges where the shares of the target company are listed.

### Answer 3(c)

In the interests of better regulation of and orderly development of the securities market, SEBI has issued SEBI (Informal Guidance) Scheme 2003. The following persons may make a request for informal Guidance under the scheme:

- (a) any intermediary registered with the SEBI.
- (b) any listed company.
- (c) any company which intends to get any of its securities listed and which has filed either a listing application with any stock exchange or a draft offer document with the SEBI or the Central Listing authority.
- (d) any mutual fund trustee company or asset management company.
- (e) any acquirer or prospective acquirer under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997. (Now SEBI Takeover Regulations, 2011)

The Guidance Scheme, further deals with various aspects such as the nature of request, fees to be accompanied along with request letter, disposal of requests, SEBI's discretion not to respond certain types of requests and confidentiality of requests, etc.

### Question 4

- (a) *The price of equity share of a listed company viz. NextDial Ltd. (NDL) increased from ₹10 to high of ₹50 i.e. a rise of 500% during the period 1st April, 2018 to 30th Sept., 2018. NDL had entered into a Share Purchase Agreement (SPA) with the proposed acquirer(s) to acquire 40% of the subscribed equity share capital as of 31st Aug., 2018 which would result in change of management. This initial discussion on the deal was made on 1st April, 2018 but SPA was signed on 25th April, 2018. During 1st April, 2018 to 30th Sept., 2018, the promoter and his wife dealt in the script of NextDial Ltd. Referring to the provisions of SEBI (PIT) Regulations, answer the following :*

- (i) *Define Unpublished Price Sensitive Information.*
- (ii) *Whether there was any Unpublished Price Sensitive Information (UPSI) ?*
- (iii) *What will be the date of UPSI ?*
- (iv) *What are the factors to be taken into account by the adjudicating officer while imposing penalty for the act ?* (8 marks)

(b) *The financial data of Natural Energy Limited as on 31st March, 2018 are as under :*

(i) *Authorised Share Capital : ₹700 crore*

(ii) *Paid-up Capital : ₹300 crore*

(iii) *Free Reserves : ₹800 crore*

*The company has pending convertible debenture of ₹150 crore, due for conversion in financial year 2018-19. The company proposes to issue bonus shares in the ratio of 1 : 1 after conversion of debenture. You being a company secretary, advise on the procedure to be followed by referring SEBI regulations.*

*(7 marks)*

**Answer 4(a)**

(i) The SEBI (Prohibition of Insider Trading) Regulations, 2015 defines “Unpublished Price Sensitive Information” which means any information, relating to a company or its securities, directly or indirectly, that is not generally available which upon becoming generally available, is likely to materially affect the price of the securities and shall, ordinarily including but not restricted to, information relating to the following:-

(i) financial results;

(ii) dividends;

(iii) change in capital structure;

(iv) mergers, de-mergers, acquisitions, delistings, disposals and expansion of business and such other transactions;

(v) changes in key managerial personnel.

(ii) The promoter of Next Dial Ltd. was involved in the negotiation for fixing the share price and traded in the shares of the company while being privy to the price sensitive information. Therefore, it is alleged that promoter had dealt in the shares of the company while in possession of or on the basis of the Unpublished Price Sensitive Information (UPSI). Additionally, he has also communicated or counseled, directly or indirectly, the UPSI to his wife, who in turn has also traded in the shares of the company.

The definition of Price Sensitive Information also includes the following as Price Sensitive Information; (a) amalgamation, mergers or takeovers, (b) disposal of the whole or substantial part of the undertaking. So Unpublished Price Sensitive Information (UPSI) was existed.

(iii) In the mentioned case, Share Purchase Agreement (SPA) was signed on 25th April, 2018. Taking into consideration when the SPA was signed, the UPSI is considered to have originated on April 25, 2018.

(iv) While imposing monetary penalty, it is obligatory to consider the factors stipulated in Section 15J of the SEBI Act, 1992 which reads as under:

a. the amount of disproportionate gain or unfair advantage, whenever quantifiable, made as a result of the default;

- b. the amount of loss caused to an investor or group of investors as a result of the default;
- c. the repetitive nature of the default.

**Answer 4(b)**

Chapter XI consisting of regulation 293-295 of the SEBI (ICDR) Regulations, 2018 stipulates the provisions with respect to issue of bonus shares. Regulation 293 provides that, subject to the provisions of the Companies Act, 2013 or any other applicable law, a listed issuer shall be eligible to issue bonus shares to its members if:

- (i) it is authorized by its Articles of Association for issue of bonus shares, capitalization of reserves, etc;  
 Provided that if there is no such provision in the Articles of Association, the issuer shall pass a resolution at its general body meeting making provisions in the Articles of Association for capitalization of reserve;
- (ii) it has not defaulted payment of interest or principal in respect of fixed deposits or debt securities issued by it;
- (iii) it has not defaulted in payment of statutory dues of the employees such as contribution to provident fund, gratuity and bonus;
- (iv) any outstanding partly paid shares on the date of the allotment of the bonus shares are made fully paid-up;
- (v) any of its promoters or directors is not a fugitive economic offender.

The Article of Association must authorize it to issue the bonus shares. If there is no provision in the Article for Bonus shares, firstly articles shall be amended by the company.

Determination of increase in authorized capital required:

- |   |   |                                |
|---|---|--------------------------------|
| a. Paid-up share capital as on 31/03/2018               | : | Rs. 300 crores                 |
| b. Paid-up share capital after conversion of debentures | : | Rs. 450 crores                 |
| c. Proposed Bonus issue                                 | : | One share for every share held |
| d. Post Bonus issue Capital                             | : | Rs. 900 Crores                 |

Since authorized capital is Rs.700 crores only, it is required to increase the authorized capital by 200 crores or more.

The Reserves & Surplus is Rs. 800 crores, therefore bonus issue of Rs. 450 crores can be made out of reserves & surplus.

Other conditions to be followed:

- Bonus shares shall not be issued in lieu of dividend
- A resolution shall be passed by the Board in its meeting
- Bonus issue shall be completed within 15 days from the date of approval of Board of Directors, if shareholders' approval is not required

- Where approval of shareholders is required, bonus issue shall be completed within 2 months from the date of meeting of Board of Directors wherein the decision to announce the bonus issue was taken subject to shareholder's approval
- A bonus issue, once announced, shall not be withdrawn.

## PART II

### Question 5

- (a) *What are the Option contracts ? You are required to compute the profit/loss for each investors in below option contracts :*
- Mr. X writes a call option to purchase share at an exercise price of ₹60 for a premium of ₹12 per share. The share price rises to ₹62 by the time the option expires.*
  - Mr. Y buys a put option at an exercise price of ₹80 for a premium of ₹8.50 per share. The share price falls to ₹60 by the time the option expires.*
  - Mr. Z writes a put option at an exercise price of ₹80 for a premium of ₹11 per share. The price of the share rises to ₹96 by the time the option expires.*
  - Mr. XY writes a put option with an exercise price of ₹70 for a premium of ₹8 per share. The price falls to ₹48 by the time the option expires.*
- (b) *What do you mean by 'Research Analysts' ? Elucidate the net worth requirements, and role and responsibilities of Research Analyst as per SEBI (Research Analyst) Regulations, 2014.*
- (c) *"Prior information of open position of any share during market hours can easily fluctuate the price of the share". How Preventive Surveillance helps to reduce the fraudulent price variation in the shares in a day ? (5 marks each)*

### Answer 5(a)

Options Contract give its holder the right, but not the obligation, take or make delivery on or before a specified date at a stated price.

Option Contracts are classified into two types on the basis of which party has the option:

- Call Option – A call option is with the buyer and gives the right to take delivery. The buyer of the call option has a right to buy the underlying asset from the option seller.
- Put Option – The put option is with the seller and the option gives the right to take delivery. The buyer of the put option has a right to sell the underlying asset to the option seller.
  - For Mr. X : Profit =  $[(Rs. 60 - Rs. 62) + Rs. 12] = Rs. 10$
  - For Mr. Y : Profit =  $[(Rs. 80 - Rs. 60) - Rs. 8.50] = Rs. 11.50$
  - For Mr. Z : Profit = Rs. 11.00 (Option will not be exercised)
  - For Mr. XY : Loss =  $[(Rs. -70 + Rs. 48) + Rs. 8] = - Rs. 14$

**Answer 5(b)**

As per the SEBI (Research Analysts) Regulations, 2014, “Research Analyst” means a person who is primarily responsible for:

- i. preparation or publication of the content of the research report; or
- ii. Providing research report; or
- iii. making ‘buy / sell / hold recommendation; or
- iv. giving price target; or
- v. offering an opinion concerning public offer, with respect to securities that are listed or to be listed in a stock exchange, whether or not any such person has the job title of ‘Research Analyst’ and include any other entities engaged in issuance of Research Report or Research Analysis.

*Net worth requirement* : Body Corporate or Limited Liability Partnership firm – not less than Rs. 25 lakhs; Individual or Partnership firm shall have net tangible assets of value not less than Rs. 1 Lakh.

*Role and Responsibility* : They study companies and Industries, analyse raw data and make forecast or recommendations about whether to buy, hold or sell securities. They analyse information to provide recommendations about investments in securities to their clients. Investors often view analysts as experts and important source of information about the securities they review and often rely on their advice. There are basically three broad types of analysts, viz. sell-side analysts, buy-side analysts and independent analysts.

**Answer 5(c)**

Market Surveillance plays a vital role in ensuring market integrity which is core objective of regulators. Market integrity is achieved through combination of surveillance, inspection, investigation and enforcement of relevant laws and rules. Globally Market Surveillance is either conducted by the regulators or Exchanges or both. In India, the primary responsibility of market surveillance has been entrusted to Stock exchanges and is being closely monitored by SEBI. Market Surveillance is broadly categorized in two parts, viz. Preventive Surveillance and Post Trade Surveillance.

**Preventive Surveillance**

- Stringent on-boarding norms for Trading members – Stringent net worth, back ground, viability, etc. checks while on boarding Trading members.
- Index Circuit Filters – It brings coordinated trading halt in all equity and equity derivative markets at 3 stages of the index movement, either way viz. at 10%, 15% and 20% based on previous day closing index value.
- Trade Execution range – Orders are matched and trades take place only if the trade price is within the reference price and execution range.
- Order Value Limitation – Maximum Order Value limit allowed per order.
- Cancel on Logout – All outstanding orders are cancelled, if the enabled user logs out.

- Kill Switch – All outstanding orders of the trading member are cancelled if trading members executes kill switch.
- Risk Reduction Mode – Limits beyond which order level risk management shall be initiated instead of trade level.
- Compulsory Close out – Incoming order, if it results in members crossing the margins available with the exchange, such order will be partially or fully cancelled, as the case may be, and further disallow the trading member to create fresh positions.
- Capital Adequacy Check – Refers to monitoring of trading member's performance and track record, stringent margin requirements, position limits based on capital, online monitoring of member positions and automatic disablement from trading when limits are breached.
- Fixed Price Band / Dynamic Price band – Limits applied within which securities shall move; so that volatility is curbed, orderliness is brought about. For non-derivative securities, price band is 5%, 10% & 20%. For derivative products as operating range of 10% is set and subsequently flexed based on market conditions.
- Trade for Trade Settlement – The settlement of scrip's available in this segment is done on a trade for trade basis and netting off is allowed.
- Periodic Call Auction – Shifting the security form continuous to call auction method.
- Rumour Verification – Any unannounced news about listed companies is tracked on online basis and letter seeking clarification is sent to the companies and the reply received is disseminated.

**Attempt all parts of either Q. No. 6 or Q. No. 6A**

**Question 6**

*Write short notes on the following :*

- (a) *Custodian of Securities*
- (b) *Key difference between WPI & CPI*
- (c) *Basis of SENSEX*
- (d) *High Net Worth Individuals*
- (e) *Bulk Deal.*

*(3 marks each)*

**OR (Alternate question to Q. No. 6)**

**Question 6A**

- (i) *"An Alternative Investment Fund which has been granted registration under a particular category cannot change its category subsequent to registration, except with the approval of the SEBI". Enumerate the conditions for approval of SEBI.*
- (ii) *Dhruv has purchased 1000 shares @ ₹80 per share of a company. He wanted to pay ₹5,000 in cash and balance through bank transfer to stock broker. As a Company Secretary advise Dhruv by referring SEBI regulation/circular.*

- (iii) *"SEBI has amended the provisions related to registration of Sub-Broker to act as a market intermediary". Elucidate the statement and discuss the migration path for existing registered Sub-Brokers. (5 marks each)*

**Answer 6(a)**

As per the SEBI (Custodian) Regulations, 1996, a custodian is a person who carries on the business of providing custodial service to the client. The custodian keeps the custody of the securities of the client. The custodian also provides incidental services such as maintaining the accounts of securities of the client, collecting benefits or rights accruing to the client in respect to the securities.

Roles and Responsibilities:

- Administrate and protect the assets of the clients
- Open a separate custody account and deposit account in the name of each client
- Record Assets
- Conduct registration of Securities

Net Worth: Minimum Rs. 50 crore.

**Answer 6(b)**

Key difference between Wholesale Price Index (WPI) & Consumer Price Index (CPI)

- i. Primary use of WPI is to have inflationary trend in the economy as a whole. However, CPI is used for adjusting income and expenditure streams for changes in the cost of living.
- ii. WPI is based on wholesale prices for primary articles, administered process for fuel items and ex-factory prices for manufactured products. On the other hand, CPI is based on retail prices, which include all distribution costs and taxes.
- iii. Prices of WPI are collected on voluntary basis while price data for CPI is collected by Investigators by visiting markets.
- iv. CPI covers only consumer goods and consumer services while WPI covers all goods including intermediate goods transacted in the economy.
- v. WPI weights primarily based on national accounts and enterprise survey data and CPI weights are derived from consumer expenditure survey data.

**Answer 6(c)**

Sensitive Index or Sensex is the stock market index for the BSE. It is also sometimes referred to as BSE S&P Sensex. The calculation of Sensex is done by a Free-Float method that came into existence from September 1, 2003. The level of Sensex is direct indication of the performance of 30 stocks in the market. The free-float method takes into account the proportion of the shares that can be readily traded in the market. This does not include the ones held by various shareholders and promoters or other locked-shares not available in market.

**Steps to calculate Sensex**

- The market capitalization is taken into account. This is done by multiplying all the shares issued by the company with the price of its stock.
- BSE determines a Free-Float factor that is a multiple of the market capitalization of the company. This helps in determining the free-float factor market capitalization based on details submitted by the company.
- Ratio and Proportion are used based on the base index of 100. This helps to determine the Sensex.

**Answer 6(d)**

HNI or High Net worth Individuals is a class of individuals who are distinguished from other retail segment based on their net wealth, assets and investible surplus. While there is no standard put forth for the classification, the definition of HNIs varies with the geographical area as well as financial markets and institutions.

Though there is no specific definition, generally in the Indian context, individuals with over Rs. 2 crore investible surplus may be considered to be HNIs while those with investible wealth in the range of Rs. 25 lakhs to Rs. 2 crore may be deemed as Emerging HNIs.

If one is applying for an IPO of the equity shares in an Indian Company, generally, if one apply for amounts in excess of Rs. 2 lakhs, one falls under the HNI category. On the other hand, if one apply for amount under Rs. 2 lakhs, one is considered as a retail investor.

**Answer 6(e)**

Bulk deal is a trade, where total quantity bought or sold is more than 0.5% of the number of equity shares of a listed company.

Bulk deal can be transacted by the normal trading window provided by brokers throughout the trading hours in a day. Bulk deals are market driven and take place throughout the trading day.

The stock broker, who facilitates the trade, is required to reveal to the Stock Exchange about the bulk deals on daily basis.

Bulk orders are visible to everyone. If the bulk deal happens through a single trade, it should be notified to the Stock Exchange immediately upon the execution of the order. If it happens through multiple trades, it should be notified to the exchange within one hour from the closure of the trading.

**Answer 6A(i)**

As per SEBI Circular No. CIR/IMD/DF/12/2013 dated 7th August, 2013, only AIFs who have not made any investments under the category in which they were registered earlier shall be allowed to make application for change in category. Such AIFs are required to make an application in Form A along with necessary supporting documents. Application fees of Rs. 1, 00,000 must be paid along with the application to SEBI. AIFs are not required to pay registration fees for such applications.

If the AIF has received commitments/ raised funds prior to application for change in category, the AIF shall be required to send letters/ emails to all its investors providing them the option to withdraw their commitments/ fund raised without any penalties/ charges. Any fees collected from investors seeking to withdraw commitments/ funds shall be returned to them. Partial withdrawal may be allowed subject to compliance with the minimum investment amount required under the AIF regulations.

The AIF shall not make any investments till deployment of fund as per the scheme other than in liquid funds/ bank deposits until approval for change in category is granted by SEBI.

On approval of the request from SEBI, the AIF is required to send a copy of the revised placement memorandum and other relevant information to all its investors.

**Answer 6A(ii)**

SEBI vide its circular no. SEBI/HO/MIRSD/DoP/CIR/P/2018/113 dated 12/07/2018 has discontinued acceptance of cash by Stock Brokers.

In view of the various modes of payments through electronic means available today, it is directed that Stock Brokers shall not accept cash from their clients either directly or by way of cash deposit to the bank account of stock broker.

All payments shall be received / made by the Stock Brokers from/to the clients strictly by account payee crossed cheques/ demand draft or by way of credit into the bank account through electronic fund transfer, or any other mode permitted by the Reserve Bank of India. The stock brokers shall accept cheques drawn only by the clients and also issue cheques in favour of the clients only, for their transactions. Stock Brokers shall not accept cash from their clients either directly or by way of cash deposit to the bank account of Stock Broker.

**Answer 6A(iii)**

Under the current regulatory framework, Sub-Brokers ('SB') need to seek registration from SEBI under SEBI (Stock Broker and Sub-Broker) Regulations, 1992, and Authorized Persons ('AP') need to seek registration from the concerned Exchange. There is no difference in the operative role of a Sub-Broker and that of an Authorized Person. Therefore, SEBI vide its circular no. SEBI/HO/MIRSD/DoP/CIR/P/2018/117 dated 03/08/2018 has discontinued with sub-broker as an intermediary to be registered with SEBI. In view of the same, the need for the category of the Sub-Broker as a market intermediary may no longer be required. Therefore, it is decided that –

- (a) No fresh registration shall be granted to any person as Sub-Broker. Any pending applications for registration as Sub-Broker under process, shall be returned to the concerned Stock Exchanges for onward transmission to the applicant.
- (b) The registered Sub-Brokers shall have time till March 31, 2019 in order to migrate to act as an Authorised Person (AP) and / or Trading Member (TM). The sub-Brokers, who do not choose to migrate into AP and / or TM, shall deemed to have surrendered their registration with SEBI as Sub-Broker, w.e.f. March 31, 2019.
- (c) Consequent upon migration/deemed surrender, the Certificate of Registration granted to the Sub-Broker by SEBI shall stand withdrawn.

- (d) The migration path for existing registered Sub-Broker, shall be under:
- i. In case of a registered Sub-Broker who is already approved to act as AP in Derivatives Segment of the Exchanges, he shall be registered with the Exchanges to continue activities of Sub-Broker as AP in Cash Segment.
  - ii. In case of a registered Sub-Broker who is not approved by Stock Exchanges to act as AP in Derivatives Segment, Exchanges shall register them as AP in Cash Segment, to continue their operations without disruption.
  - iii. The existing Sub-Broker has an option to become a Trading Member, if the Sub-Broker meets the eligibility criteria prescribed under Stock Exchange Bye-Laws and SEBI Regulations and by complying with these Regulations.

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## ECONOMIC BUSINESS AND COMMERCIAL LAWS

Time allowed : 3 hours

Maximum marks : 100

**NOTE :** Answer **ALL** Questions.

### PART I

#### Question 1

- (a) Reserve Bank of India is a banker of banks. Comment.
- (b) How a person resident in India can hold, own, transfer or invest in any immovable property situated outside India. Comment.
- (c) Explain under what circumstances the Central Government is empowered to supersede any authority constituted under Special Economic Zones Act, 2005? What will be the consequences if such power is exercised by Central Government ?
- (d) What are the conditions for the Indian Company to allot sweat equity shares of its holding company to its employees, who are resident outside India.

(5 marks each)

#### Answer 1(a)

From the perusal of following functions of Reserve Bank of India (RBI), it is rightly said that Reserve Bank of India (RBI) is a Banker of Banks:

The Reserve Bank of India opens current accounts of banks with itself, enabling these banks to maintain cash reserves as well as to carry out inter-bank transactions through these accounts. Inter-bank accounts can also be settled by transfer of money through electronic fund transfer system, such as, the Real Time Gross Settlement System (RTGS).

In addition, the Reserve Bank has also introduced the Centralised Funds Management System (CFMS) to facilitate centralised funds enquiry and transfer of funds across Deposit Accounts Department (DADs). This helps banks in their fund management as they can access information on their balances maintained across different DADs from a single location.

As Banker of Banks, the Reserve Bank provides short-term loans and advances to selected banks, when necessary, to facilitate lending to specific sectors and for specific purposes. These loans are provided against promissory notes and other collateral given by the banks.

The Reserve Bank also acts as the 'lender of last resort'. It can come to the rescue of a bank that is solvent but faces temporary liquidity problems by supplying it with much needed liquidity when no one else is willing to extend credit to that bank. The Reserve Bank extends this facility to protect the interest of the depositors of the bank and to prevent possible failure of a bank, which in turn may also affect other banks and institutions and can have an adverse impact on financial stability and thus on the economy.

**Answer 1(b)**

According to section 6(4) of the Foreign Exchange Management Act, 1999 read with Foreign Exchange Management (Acquisition and Transfer of immovable property outside India) Regulations, 2015, a person resident in India can hold, own, transfer or invest in any immovable property situated outside India if such property was acquired, held or owned by him/ her when he/ she was resident outside India or inherited from a person resident outside India.

A person resident in India can acquire immovable property outside India by way of gift or inheritance from a person resident in India who has acquired such property in accordance with the foreign exchange provisions in force at the time of such acquisition.

A person resident in India can purchase immovable property outside India out of foreign exchange held in his/ her Resident Foreign Currency (RFC) account.

A person resident in India can acquire immovable property outside India jointly with a relative who is a person resident outside India, provided there is no outflow of funds from India.

**Answer 1(c)**

Section 40 of the Special Economic Zones Act, 2005 empowers the Central Government to supersede an Authority for a maximum period of six months if at any time, it is of the opinion that an Authority is unable to perform, or has persistently made default in the performance of the duty imposed on it or has exceeded or abused its powers, or has wilfully or without sufficient cause, failed to comply with any direction issued by it. However, before issuing a notification superseding an authority, the Central Government is required to give reasonable time to that Authority to make representation against the proposed suppression and consider the representations, if any, of the Authority.

Section 40(2) of the Special Economic Zones Act, 2005 dealing with the consequences of publication of the notification superseding the Authority provides that

- (a) the Chairperson and other Members of the Authority shall, notwithstanding that their term of office has not expired as from the date of supersession, vacate their offices as such;
- (b) all the powers, functions and duties which may, by or under the provisions of the Act, be exercised or discharged by or on behalf of the Authority shall, during the period of supersession, be exercised and performed by such person or persons as the Central Government may direct;
- (c) all property vested in the Authority shall, during the period of supersession, vest in the Central Government.

**Answer 1(d)**

Conditions for the Indian company to issue/allot sweat equity shares to its employees/ directors or employees/directors of its holding company who are resident outside India, are as under:

- (a) The scheme has been drawn either in terms of regulations issued under the

Securities Exchange Board of India Act, 1992 or the Companies (Share Capital and Debentures) Rules, 2014 notified by the Central Government under the Companies Act 2013, as the case may be.

- (b) The “sweat equity shares” issued to non-resident employees/directors under the applicable rules/regulations are in compliance with the sectoral cap applicable to the said company.
- (c) Issue of “sweat equity shares” by a company where foreign investment is under the approval route shall require prior approval of Government of India.
- (d) Issue of “sweat equity shares” under the applicable rules/regulations to an employee/director who is a citizen of Bangladesh/Pakistan shall require prior approval of the Government of India.
- (e) The issuing company shall furnish to the Regional Office concerned of the Reserve Bank of India under whose jurisdiction the registered office of the company operates, within 30 days from the date of issue of employees’ stock option or sweat equity shares, a return as per the Form-ESOP.

**Attempt all parts of either Q. No. 2 or Q. No. 2A**

**Question 2**

- (a) *Explain the permissible capital account transactions by an individual under the liberalised remittance scheme.* (4 marks)
- (b) *Explain the objectives of ‘Foreign Trade Policy’ under the Foreign Trade Policy for 2015-2020.* (4 marks)
- (c) *What do you understand by “Offshore Banking Unit” under Special Economic Zone Act, 2005 ?* (4 marks)
- (d) *Whether conversion of ‘External Commercial Borrowing’ into equity is permissible? Comment.* (4 marks)
- (e) *Discuss the objectives of enacting the Foreign Exchange Management Act, 1999. Explain in brief the scheme of Foreign Exchange Management Act, 1999.* (4 marks)

**OR (Alternate question to Q. No. 2)**

**Question 2A**

- (i) *State the sources within which the Indian mutual funds registered with SEBI are permitted to invest in overseas direct investment.*
- (ii) *What are the reporting requirements for non-banking financial companies ?*
- (iii) *Under what conditions ‘Foreign Direct Investment’ in limited liability partnership is permitted.*
- (iv) *How the “Special Economic Zone Authority” is constituted under Special Economic Zone Act, 2005 ? Which are the defects or irregularities for which any act or proceedings of an authority can not be invalidated ?*

- (v) *'Non-Banking Financial Companies' are akin to that of bank, but they differ from banks in certain cases. Explain.* (4 marks each)

**Answer 2(a)**

The permissible capital account transactions by an individual under Liberalised Remittance Scheme are:

- (i) Opening of foreign currency account abroad with a bank.
- (ii) Purchase of property abroad.
- (iii) Making investments abroad- acquisition and holding shares of both listed and unlisted overseas company or debt instruments.
- (iv) Acquisition of qualification shares of an overseas company for holding the post of Director, acquisition of shares of a foreign company towards professional services rendered or in lieu of Director's remuneration.
- (v) Investments in units of Mutual Funds, Venture Capital Funds, Unrated debt securities, promissory notes
- (vi) Setting up wholly owned subsidiaries and Joint Ventures outside India for bonafide business subject to the stipulated terms and conditions.
- (vii) Extending loans including loans in Indian rupees to Non-Resident Indians (NRIs) who are relatives as defined in the Companies Act.

**Answer 2(b)**

India's Foreign Trade Policy (FTP) has, conventionally, been formulated for five years at a time and reviewed annually. The focus of the FTP has been to provide a framework of rules and procedures for exports and imports and a set of incentives for promoting exports. The FTP for 2015-20 seeks to achieve the following:-

- (i) To provide a stable and sustainable policy environment for foreign trade in merchandise and services;
- (ii) To link rules, procedures and incentives for exports and imports with other initiatives such as "Make in India", Digital India and Skill India to create an 'Export Promotion Mission' for India;
- (iii) To promote the diversification of India's export by helping various sectors of the Indian economy to gain global competitiveness with a view to promote exports;
- (iv) To create an architecture for India's global trade engagement with a view to expanding its markets and better integrating with major regions, thereby increasing the demand for India's product and contributing to the government's flagship "Make in India" initiative;
- (v) To provide a mechanism for regular appraisal in order to rationalise imports and reduce the trade imbalance.

**Answer 2(c)**

According to Section 2(u) of the Special Economic Zones Act, 2005, "Offshore Banking Unit" means a branch of a bank located in a Special Economic Zone and which

has obtained the permission under Section 23 (1)(a) of the Banking Regulation Act, 1949.

An application for setting up and operation of an Offshore Banking Unit in a Special Economic Zone may be made to the Reserve Bank, in the prescribed form and manner. The Reserve Bank may, by notification, specify the terms and conditions subject to which an Offshore Banking Unit may be set up and operated in the Special Economic Zone.

**Answer 2(d)**

Indian companies have been granted general permission for conversion of External Commercial Borrowings (ECB) (excluding those deemed as ECB) in convertible foreign currency into equity shares/fully compulsorily and mandatorily convertible preference shares, subject to the following conditions and reporting requirements:

- (a) The activity of the company is covered under the Automatic Route for FDI or the company has obtained Government approval for foreign equity in the company;
- (b) The foreign equity after conversion of ECB into equity is within the sectoral cap, if any;
- (c) Pricing of shares is as per the issue price of shares;
- (d) Compliance with the requirements prescribed under any other statute and regulation in force; and
- (e) The conversion facility is available for ECBs availed under the Automatic or Government Route and is applicable to ECBs, due for payment or not, as well as secured/unsecured loans availed from non-resident collaborators.

**Answer 2(e)**

Foreign Exchange Management Act, 1999 enacted to consolidate and amend the law relating to foreign exchange with the objective of facilitating external trade and payments and for promoting the orderly development and maintenance of foreign exchange market in India. In fact it is the central legislation that deals with inbound investments into India and outbound investments from India and deal with trade and business between India and the other countries.

Foreign Exchange Management Act, 1999 makes provisions for dealings in foreign exchange. Broadly, all Current Account Transactions are free. However, Central Government can impose reasonable restrictions by issuing Rules. Capital Account Transactions are permitted to the extent specified by Reserve Bank of India (RBI) by issuing Regulations. Foreign Exchange Management Act, 1999 envisages that RBI shall have a controlling role in management of foreign exchange. Since RBI cannot directly handle foreign exchange transactions, it authorizes “Authorised Persons” to deal in foreign exchange.

Foreign Exchange Management Act, 1999 also makes provisions for enforcement, penalties, adjudication and appeal also contains only basic legal framework. The practical aspects are covered in Rules made by Central Government and Regulations made by RBI.

**Answer 2A(i)**

Indian Mutual Funds registered with SEBI are permitted to invest in overseas direct investment in the following:

- a. American Depositary Receipts (ADRs) / Global Depositary Receipts (GDRs) of the Indian and foreign companies;
- b. Equity of overseas companies listed on recognized overseas stock exchanges; initial and follow on public offerings for listing at recognized overseas stock exchanges;
- c. Foreign debt securities- short term as well as long term with rating not below investment grade - in the countries with fully convertible currencies;
- d. Money market investments not below investment grade; repos where the counter party is not below investment grade;
- e. Government securities where countries are not rated below investment grade;
- f. Derivatives traded on recognized stock exchanges overseas only for hedging and portfolio balancing with underlying as securities;
- g. Short term deposits with banks overseas where the issuer is rated not below investment grade; and
- h. Units / securities issued by overseas Mutual Funds or Unit Trusts registered with overseas regulators.

**Answer 2A(ii)**

The reporting requirements for Non-Banking Financial Companies are:-

- (1) The Non-Banking Financial Company may, from time to time, prescribe returns to be submitted by NBFC-P2P, as it deems fit.
- (2) The following quarterly statements shall be submitted to the Regional Office within 15 days after the quarter to which these relate
  - A statement, showing the number and amount in respect of loans;
    - disbursed during the quarter;
    - closed during the quarter; and
    - outstanding at the beginning and at the end of the quarter, including the number of lenders and borrowers outstanding as at the end of the quarter
  - The amount of funds held in the Escrow Account, bifurcated into funds received from lenders and funds received from borrowers, with credit and debit summations for the quarter.
  - Number of complaints outstanding at the beginning and at the end of quarter, and disposed of during the quarter, bifurcated as received from lenders and borrowers.
  - The Leverage Ratio, with details of its numerator and denominator.

**Answer 2A(iii)**

Foreign Direct Investment (FDI) in Limited Liability Partnership (LLPs) is permitted subject to the following conditions:

- (i) FDI is permitted under the automatic route in Limited Liability Partnership (LLPs) operating in sectors/activities where 100% FDI is allowed through the automatic route and there are no FDI linked performance conditions.
- (ii) An Indian company or an LLP having foreign investment, is also permitted to make downstream investment in another company or LLP in sectors in which 100% FDI is allowed under the automatic route and there are no FDI-linked performance conditions.
- (iii) FDI in LLP is subject to the compliance of the conditions of Limited Liability Partnership Act, 2008.

**Answer 2A(iv)**

Section 31 of Special Economic Zone Act, 2005 empowers the Central Government to constitute by notification in the Official Gazette, Special Economic Zone Authority' for every Special Economic Zone to exercise powers conferred on and discharge the functions assigned to it.

Section 31(9) of Special Economic Zone Act, 2005 stipulates that no act or proceedings of an authority shall be invalidated merely by reason of:

- (i) any vacancy in or any defect;
- (ii) any defect in the appointment of a person as its member; or
- (iii) any irregularity in the procedure of the authority not affecting the merits of the case.

**Answer 2A(v)**

A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, engaged in the business of loans and advances, acquisition of shares/stocks/bonds/debentures/securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property.

NBFCs lend and make investments and hence their activities are akin to that of banks; however there are few differences such as:

- (i) NBFC cannot accept demand deposits.
- (ii) NBFC's do not form part of the payment and settlement system and cannot issue cheques drawn on itself.
- (iii) Deposit insurance facility of Deposit Insurance and Credit Guarantee Corporation is not available to depositors of NBFC's unlike in the case of banks.

**PART-II****Question 3**

- (a) *How the competition commission will determine whether an agreement has appreciable adverse effect on competition ?*
- (b) *Whether the jurisdiction of the competition commission of India extends to acts/ agreements taking place outside India, which affects competition in India ? Explain.*
- (c) *What is the purpose of competition policy of India and Competition Act, 2002 ?*
- (d) *What is meant by dominant position under the Competition Act, 2002 ?*
- (e) *Discuss the consequences of making false statement by a person being a party to combination under Competition Act, 2002. (3 marks each)*

**Answer 3(a)**

Section 19(3) of the Competition Act, 2002 provides that while determining whether an agreement has appreciable adverse effect on competition, the Commission shall give due regard to all or any of the following factors, namely:

- (a) creation of barriers to new entrants in the market;
- (b) driving existing competitors out of the market;
- (c) foreclosure of competition by hindering entry into the market;
- (d) accrual of benefits to consumers;
- (e) improvements in production or distribution of goods or provision of services;
- (f) promotion of technical, scientific and economic development by means of production or distribution of goods or provision of services.

**Answer 3(b)**

Section 32 of the Competition Act, 2002 deals with acts taking place outside India but having an effect on competition in India. Section 32 of the Competition Act, 2002 extends the jurisdiction of Competition Commission of India to inquire and pass orders in accordance with the provisions of the Act into an agreement or dominant position or combination, which is likely to have, an appreciable adverse effect on competition in relevant market in India, notwithstanding that:

- (a) an agreement referred to in Section 3 has been entered into outside India; or
- (b) any party to such agreement is outside India; or
- (c) any enterprise abusing the dominant position is outside India; or
- (d) a combination has taken place outside India; or
- (e) any party to combination is outside India; or
- (f) any other matter or practice or action arising out of such agreement or dominant position or combination is outside India.

The above clearly demonstrates that acts taking place outside India but having an effect on competition in India will be subject to the jurisdiction of Commission. The Competition Commission of India will have jurisdiction even if both the parties to an agreement are outside India but only if the agreement, dominant position or combination entered into by them has an appreciable adverse effect on competition in the relevant market of India.

**Answer 3(c)**

The basic purpose of Competition Policy and Competition Act, 2002 is to preserve and promote competition as a means of ensuring efficient allocation of resources in an economy. Competition policy typically has two elements:

- (i) One is a set of policies that enhance competition in local and national markets.
- (ii) The second element is legislation designed to prevent anti-competitive business practices with minimal Government intervention, i.e., a competition law.

The Competition Act, 2002 seeks to provide, keeping in view the economic development of the country, for the establishment of Competition Commission to prevent practices having adverse effect on competition, to promote and sustain competition in markets, to protect the interests of consumers and to ensure freedom of trade carried on by other participants in markets in India.

**Answer 3(d)**

According to Section 4 of the Competition Act, 2002 dominant position means a position of strength, enjoyed by an enterprise or group, in the relevant market, in India, which enables it to–

- (i) operate independently of competitive forces prevailing in the relevant market; or
- (ii) affect its competitors or consumers or the relevant market in its favour”.

**Answer 3(e)**

Section 44 of the Competition Act, 2002 provides that if any person, being a party to a combination, makes a statement which is false in any material particular, or knowing it to be false; or omits to state any material particular knowing it to be material, such person shall be liable to a penalty which shall not be less than rupees fifty lakhs but which may extend to rupees one crore, as may be determined by the Commission.

**Question 4**

- (a) *The Competition Act, 2002 is an improvement on the MRTP Act, 1969. Critically analyse this statement.*
- (b) *Explain what is meant by Bid-rigging, tie-in agreement, Exclusive supply agreement, and Refusal to deal. (5 marks each)*

**Answer 4(a)**

It is true that the Competition Act, 2002 is an improvement on the MRTP Act, 1969.

Following differences in the MRTP Act, 1969 and the Competition Act, 2002 support this statement:

(i) *Difference in goals as stated in Preamble of the Acts*

- The MRTP Act, 1969 aimed at prevention of concentration of economic power and prohibition of monopolistic, restrictive and unfair trade practices while objective of the Competition Act, 2002 is to promote and sustain competition, protect the interest of consumers and ensure freedom of trade carried on by other participants, in markets in India.
- The broad objective of MRTP Act, 1969 was to control monopolies while the objective of the Competition Act 2002 is to promote competition.

(ii) *Difference in provisions w.r.t. dominance*

- According to MRTP Act, 1969, dominance per se is bad while the provisions of Competition Act, 2002 states that it's not dominance which is prohibited but it is abuse of dominance which is per se bad.

(iii) *Regulation of Merger & Acquisitions (Combination)*

- MRTP Act, 1969 did not provide for regulation of merger & acquisition while the Competition Act, 2002 provides for regulation of merger & acquisition which is absolutely important in the new regime of liberalization.

(iv) *Provision for penalties*

- MRTP Act, 1969 did not provide for penalties specifically while the Competition Act, 2002 specifically provides for imposition of penalties for violations under the Act.

(v) *Advocacy provisions*

- There were no advocacy provisions for Monopolistic and Restrictive Trade Practices Commission while the Competition Act, 2002 mandates Competition Advocacy provisions for Competition Commission of India.

(vi) *Extra-territorial jurisdiction of Commission*

- Monopolistic and Restrictive Trade Practices Commission did not have extra-territorial jurisdiction beyond India in appropriate cases while Competition Commission of India is vested with extra-territorial jurisdiction in appropriate cases having adverse effect on competition in India.

**Answer 4(b)**

**Bid Rigging** : According to Section 3 of the Competition Act, 2002 “bid rigging” means any agreement, between enterprises or persons engaged in identical or similar production or trading of goods or provision of services, which has the effect of eliminating or reducing competition for bids or adversely affecting or manipulating the process for bidding

**Tie-in agreement** : Section 3 of the Competition Act, 2002, defines the term “tie-in agreement” to include any agreement requiring a purchaser of goods, as a condition of

such purchase, to purchase some other goods. A good example of tie-in agreement is where a gas distributor requires a consumer to buy a gas stove as a pre-condition to obtain connection of domestic cooking gas.

*Exclusive supply agreement* : Section 3 of the Competition Act, 2002, defines the term Exclusive supply agreement to include any agreement restricting in any manner from acquiring or otherwise dealing in any goods other than those of the seller or any other person. Thus, where a manufacturer asks a dealer not to deal in similar products of its competitor directly or indirectly and discontinues the supply on the ground that dealer also deals in product of suppliers' competitor's goods is an illustration of exclusive dealing agreement.

*Refusal to deal* : According to Section 3 of the Competition Act, 2002, the term "Refusal to deal" includes any agreement, which restricts, or is likely to restrict, by any method the persons or classes of persons to whom goods are sold or from whom goods are bought. For e.g. an agreement which provides that the franchisees will not deal in products or goods of similar nature for a period of three years from the date of determination of agreement within a radius of five kms from showroom amounts to exclusive dealing agreement.

### PART-III

#### Question 5

- (a) *Ram employed in Mumbai promised to pay ₹8,000 per month to his wife Sunita. She was living in Delhi. On receiving information that she has become unfaithful to him, Ram stopped the payment of ₹8,000 to Sunita. Sunita approaches to file a case against Ram. Advise her with reference to the Indian Contract Act, 1872. (4 marks)*
- (b) *Rajni got herself operated in the Devashri Hospital for removal of her uterus, as a cyst was found to have developed near one of her ovaries. The surgeon, who performed the operation, left abdominal pack in the abdominal. This caused lot of pain, suffering and uneasiness to her. The abdominal pack was subsequently removed by another surgical operation. It was alleged that due to negligence of the surgeon, the patient suffered all the consequences, therefore it should be treated as negligence in the treatment. But the Hospital authorities contended that the patient's problem was removed by the second operation, hence it is not deficiency. Rajni sought the relief under Consumer Protection Act, 1986 stating that this negligence may be treated as deficiency and compensation may be paid to her. Decide whether Ranji will succeed or not ? Why ? (4 marks)*
- (c) *A draws and B accepts the bill payable to C or order. C endorses the bill to D and D to E, who is 'holder in due course'. Decide from whom E can recover the amount under the Negotiable Instrument Act, 1881 ? (4 marks)*
- (d) *Sachin made an unconditional gift of property to Amit but continued in possession of gifted property. Sachin revoked the gift deed transferred it to Naresh. Amit wants to recover possession from Naresh. Discuss it in the light of provisions of Transfer of Property Act, 1882 whether Naresh can withhold the gifted property? (4 marks)*

- (e) *A minor fraudulently overstated his age and purchased a motor car after executing a promissory note in favour of the owner of the motor car for its price. The car owner compelled the minor to pay the amount of the promissory note. Whether the car owner will succeed ? Examine it with reference to Indian Contract Act, 1872 and Specific Relief Act, 1963. (4 marks)*

**Answer 5(a)**

According to section 2(h) of the Indian Contract Act, 1872, Contract is an agreement enforceable by law i.e. for an agreement to become a contract, there must be intention to create legal relationship.

In the present case, intention to create legal relationship is absent as this is a domestic arrangement between husband and wife. According to the Indian Contract Act, 1872, it does not make any difference whether the agreement is oral or in writing. So being domestic arrangement between husband and wife, it is presumed that intention to create legal relationship is absent in the present case and therefore, this agreement is not enforceable. Therefore, Sunita would not succeed in the present case. (Ref. *Balfour v. Balfour*)

**Answer 5(b)**

According to section 2(1)(g) of the Consumer Protection Act, 1986, "Deficiency" means any fault, imperfection, shortcoming or inadequacy in the quality, nature and manner of performance which is required to be maintained by or under any law for the time being in force or has been undertaken to be performed by a person in pursuance of a contract or otherwise in relation to any service.

The principles, laid down by Supreme Court in the case of *Kusum Sharma & Others versus Batra Hospital & Medical Research Centre & Others* Supreme Court (CP), shall be kept in view while deciding the cases of medical negligence. As long as the doctors have performed their duties and exercised an ordinary degree of professional skill and competence, they cannot be held guilty of medical negligence.

In the present case the doctor is liable for medical negligence as by leaving abdominal pack in the abdomen, his conduct fell below that of the standards of a reasonably competent practitioner in his field. The doctor has breached all the above stated principles. Therefore, he is liable for medical negligence.

Rajni will succeed in this case and will be entitled for compensation.

**Answer 5(c)**

According to the Negotiable Instrument Act, 1881, every prior party to a negotiable instrument is liable thereon to a holder in due course until the instrument is duly satisfied. Prior parties may include the maker or drawer, the acceptor and all the intervening endorsers to a negotiable instrument. The liability of the prior parties to a holder in due course is joint and several. The holder in due course may hold any or all prior parties liable for the amount of the dishonoured instrument.

Therefore, in present case, "E" can recover the amount payable on bill from:

- (i) "A" being drawer of bill having secondary and conditional liability arising in case of dishonor of bill.

- (ii) “B” being drawee and acceptor of bill having primary and absolute liability to pay bill.
- (iii) “C” and “D” being endorsers and prior parties to the bill.

**Answer 5(d)**

According to Section 122 of the Transfer of Property Act, once a gift is accepted by the donee/his legal representatives during life time of donor, the donor cannot revoke it.

One of the essential feature of gift is that it cannot be revoked at the will and pleasure of the grantor. A gift which comes into existence on the fulfilment of a condition, that is to say, a gift which is subject to a condition precedent is also valid.

But in this case, as gift is unconditional, therefore, after its acceptance, Sachin cannot revoke gift deed.

Applying section 41 of the Transfer of Property Act dealing with transfer by ostensible owner, in present case, Sachin (donor) is not ostensible owner as he is not holding the property with the consent of Amit (real owner). Therefore, Naresh (transferee), cannot, invoke the protection of Section 41. Amit would succeed in the case and Naresh cannot withhold the gifted property.

**Answer 5(e)**

According to the Indian Contract Act, 1872, a minor has no capacity to contract and minor's contract is absolutely void. Law of estoppel is not applicable to a minor and he can always plead his minority and is not estopped from doing so even where he had produced a loan or entered into some other contract by falsely representing that he was of full age, when in reality he was a minor.

But where the loan was obtained by fraudulent representation by the minor or some property was sold by him and the transactions are set aside as being void, the Court on equitable grounds may direct the minor to restore the property to the other party.

According to Section 33 of the Specific Relief Act, 1963 the Court may, if the minor has received any benefit under the agreement from the other party require him to restore, so far as may be such benefit to the other party, to the extent to which he or his estate has been benefited thereby.

In present case, car owner will not succeed in getting the amount of promissory note but he can get back his motor car.

***Attempt all parts of either Q. No. 6 or Q. No. 6A*****Question 6**

*Distinguish between the following :*

- (a) *Contract of service and Contract for service*
- (b) *Specific performance and Injunction*
- (c) *Cheque and Bill of Exchange*
- (d) *Mortgage and Charge*
- (e) *Conditions and Warranties.*

*(3 marks each)*

**OR (Alternate question to Q. No. 6)****Question 6A**

- (i) Explain the salient features of the Benami Transactions (Prohibition) Act, 1998. (3 marks)
- (ii) What are the effects of Money laundering on the economic development of a country? (3 marks)
- (iii) Explain the functions of 'Real Estate Regulatory Authority' under the Real Estate (Regulation and Development) Act, 2016. (3 marks)
- (iv) Whether a minor may be admitted in the business of partnership firm under the Indian Partnership Act, 1932? Whether the minor will have any right in partnership firm? Explain. (3 marks)
- (v) Against whom specific performance of a contract may be enforced under the Specific Relief Act, 1963? Explain. (3 marks)

**Answer 6(a)**

A contract for service implies a contract whereby one party undertakes to render services e.g. professional or technical services to or for another in the performance of which he is not subject to detailed direction and control but exercises professional or technical skill and uses his own knowledge and discretion.

A contract of service on the other hand implies relationship of master and servant and involves an obligation to obey orders in the work to be performed and as to its mode and manner of performance."

**Answer 6(b)**

- (a) Specific performance means the actual carrying out by the parties of their contract, and in proper cases the Court will insist upon the parties carrying out this agreement. An injunction, is an order of a Court restraining a person from doing a particular act.
- (b) Injunction is a mode of securing the specific performance of a negative term of the contract, (i.e., where he is doing something which he promises not to do), the Court may in its discretion issue an order to the defendant restraining him from doing what he promised not to do.
- (c) Injunction may be prohibitory or mandatory. In prohibitory, the Court restrains the commission of a wrongful act whereas in mandatory, it restrains continuance of a wrongful commission. Specific performance involves positive approach by the Court to direct the parties to do what they have promised under the contract.

**Answer 6(c)**

- (a) A cheque is a bill of exchange and always drawn on a banker, while a bill of exchange may be drawn on any one, including banker.
- (b) A cheque can only be drawn payable on demand, a bill of exchange may be drawn payable on demand, or on the expiry of a specified period after sight or date.

- (c) A bill of exchange payable after sight must be accepted before payment can be demanded, a cheque does not require acceptance and is intended for immediate payment.
- (d) A grace of three days is allowed in the case of time bills of exchange, while no grace is given in the case of a cheque, for payment.
- (e) The drawer of a bill of exchange is discharged, if it is not presented for payment, but the drawer of a cheque is discharged only if he suffers any damage by delay in presentment for payment.
- (f) Notice of the dishonour of a bill of exchange is necessary, but not in the case of a cheque.
- (g) The cheque being a revocable mandate, the authority may be revoked by countermanding payment, and is determined by notice of the customer's death or insolvency. This is not so in the case of bill of exchange.
- (h) A cheque may be crossed, but not a bill of exchange.

**Answer 6(d)**

- (a) A mortgage is transfer of an interest in the property made by the mortgagor as a security for the loan, while the charge is not the transfer of any interest in the property though it is security for the payment of an amount.
- (b) A charge may be created by act of parties or by operation of law. A mortgage can only be created by act of parties.
- (c) A mortgage deed must be registered and attested by two witnesses, while a charge need not be made in writing, and if reduced to writing, it need not be attested or registered.
- (d) In certain types of mortgage (viz., mortgage by conditional sale and anomalous mortgage) the mortgagor can foreclose the mortgaged property but in charge, the charge-holder cannot foreclose though he can get the property sold as in a simple mortgage.
- (e) From the very nature of it, a charge as a general rule, cannot be enforced against a transferee for consideration without notice. But in a mortgage, the transferee of mortgaged property from the mortgagor, can only acquire the remaining interest of the mortgagor, and is therefore, only bound by the mortgage.
- (f) In a charge created by act of parties the specification of the particular fund or property negatives a personal liability and the remedy of the charge-holder is against the property only. In a mortgage, there can be security as well as personal liability. In fact, the absence of a personal liability is the principal test that distinguishes a charge from a simple mortgage.

**Answer 6(e)**

According to section 12 of the Sales of Goods Act, 1930, the difference between a condition and a warranty are:-

- (a) If the stipulation forms the very basis of the contract or is essential to the main purpose of the contract, it is a condition. If the stipulation is collateral to the main purpose of the contract, i.e., is a subsidiary promise, it is a warranty.

- (b) The breach of the condition gives the aggrieved party a right to treat the contract as repudiated. The effect of a breach of a warranty is that the aggrieved party cannot repudiate the contract but can only claim damages.
- (c) If the seller fails to fulfil a condition, the buyer may treat the contract as repudiated, refuse the goods and, if he has already paid for them, recover the price. He can also claim damages for the breach of contract. If the seller does not fulfil a warranty, the buyer must accept the goods and claim damages for breach of warranty.

#### **Answer 6A(i)**

The Salient Features of the Benami Transactions (Prohibition) Act, 1988 are as under:

- (i) It defines a benami transaction and benami property and also provides for exclusions and transactions which shall not be construed benami.
- (ii) It provides the consequences of entering into a prohibited benami transactions.
- (iii) It lays down the procedure for determination and related penal consequences in the case of a prohibited benami transaction.
- (iv) It also provides that the powers of civil court shall be available to authorities under the said Act.
- (v) It empowers Central Government to make rules for the implementation of the provisions of the Act
- (vi) It enables the Central Government in consultation with the Chief Justice of the High Court to designate one or more Courts of Session as Special Court or Special Courts
- (vii) It provides penalty for entering into benami transactions and for furnishing any false documents in any proceeding under the Act

#### **Answer 6A(ii)**

The possible social, economic and political effects of money laundering, if left unchecked or dealt with ineffectively, are serious. Through the process of money laundering, organised crime can infiltrate financial institutions, acquire control of large sectors of the economy through investment, or offer bribes to public officials and indeed governments. Thus, the economic and political influence of criminal organisations can weaken the social fabric, ethical standards and ultimately the democratic institutions of society. There is a damping effect on foreign direct investment when a country's commercial and financial sectors are perceived to be subject to the control and influence of organised crime.

#### **Answer 6A(iii)**

The functions of "Real Estate Regulatory Authority" under the Real Estate (Regulation and Development) Act, 2016 are:-

- (a) to register and regulate real estate projects and real estate agents registered under the Act;

- (b) to publish and maintain a website of records, for public viewing, of all real estate projects for which registration has been given, with such details as may be prescribed, including information provided in the application for which registration has been granted;
- (c) to maintain a database, on its website, for public viewing, and enter the names and photographs of promoters as defaulters including the project details, registration for which has been revoked or have been penalised under the Act, with reasons therefor, for access to the general public;
- (d) to maintain a database, on its website, for public viewing, and enter the names and photographs of real estate agents who have applied and registered under the Act, with such details as may be prescribed, including those whose registration has been rejected or revoked;
- (e) to fix through regulations for each areas under its jurisdiction the standard fees to be levied on the allottees or the promoter or the real estate agent, as the case may be;
- (f) to ensure compliance of the obligations cast upon the promoters, the allottees and the real estate agents under the Act and the Rules and Regulations made thereunder;
- (g) to ensure compliance of its regulations or orders or directions made in exercise of its powers under the Act;
- (h) to perform such other functions as may be entrusted to the Authority by the appropriate Government as may be necessary to carry out the provisions of the Act.

#### **Answer 6A(iv)**

Drawing a joint inference from reading of Section 11 of the Indian Contract Act, 1872, the decision of the Privy Council in *Mohori Bibi v. Dharmo Das Ghose and Section 5 of the Indian Partnership Act, 1932*, a minor being incompetent to contract cannot enter into agreement of partnership. The only provision that Section 30 of the Indian Partnership Act, 1932 makes is that with the “consent of all the partners for the time being, a minor can be admitted into the benefits of partnership to which a minor is going to be admitted”. A partnership firm cannot be formed with only minors as partners. There must be at least two major partners before a minor is admitted into the benefits of partnership.

Rights of Minor as a partner:

- (i) He is entitled to his agreed share and can inspect books of account of the firm [Section 30(2)].
- (ii) He can bring a suit for account and his share when he intends to sever his connections with the firm, but not otherwise. [Section 30(4)]

#### **Answer 6A(v)**

According to Section 19 of Specific Relief Act, 1963, specific performance of a contract may be enforced against:

- (a) either party thereto,

- (b) any person claiming under him, by a title arising subsequently to the contract except a transferee for value who has paid his money in good faith and without notice of the original contract,
- (c) any person claiming under a title which though prior to the contract, and known to the plaintiff, might have been displaced by the defendant,
- (d) when a limited liability partnership has entered into a contract and subsequently becomes amalgamated with another limited liability partnership, the new limited liability partnership which arises out of the amalgamation
- (e) when a company has entered into a contract and subsequently becomes amalgamated with another company, the new company which arises out of the amalgamation,
- (f) when the promoters of a company have before its incorporation entered into a contract, for the purpose of the company and such contract is warranted by the terms of the incorporation of the company; provided that the company has accepted the contract and communicated such acceptance to the other party to the contract.

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## FINANCIAL AND STRATEGIC MANAGEMENT

Time allowed : 3 hours

Maximum marks : 100

- NOTE :**
1. Answer ALL Questions.
  2. Suitable assumptions, if considered necessary, may be made while answering a question. However, such assumptions must be stated clearly.
  3. Working notes should form part of the answer.

### PART I

#### Question 1

Comment on the following :

- (a) Investment, financing and dividend decisions are inter-related finance functions.
- (b) Term loan is associated with some specific features.
- (c) Legal, Contractual and Internal Constraints and Restrictions needs to be considered while framing dividend policy. (5 marks each)

#### Answer 1(a)

Financial Management is concerned with investment, financing and dividend decisions in relation to objectives of the company. Investment ordinarily means utilisation of money for profits or returns. Investment decisions are concerned with addition to capital assets in view to increase the net worth of the firm. Financing decision is the next step in financial management for executing the investment decision once taken. Financial decisions encompass determination of the proportion of equity capital to debt to achieve an optimal capital structure, and to balance the fixed and working capital requirements in the financial structure of the company. The dividend decision is another major area of financial management. The financial manager must decide whether the firm should distribute whole profits/part profits or retain them.

#### Answer 1(b)

##### Features of Term Loan

1. *Loan in any Currency* : These loans are provided both in home or foreign currency. Home currency loans are offered normally for purchase of fixed assets such as land, building, plant and machineries, preliminary and preoperative expenses, technical know-how, working capital etc. On the other hand, foreign currency loans are offered for import of certain plant or machinery, payment of foreign consulting fee etc.
2. *Secured Loan* : Term loans come under secured category of loans. Two kinds of securities are there –primary and collateral.
3. *Loan Installments* : Repayment of loan is done in installments. These installments cover both principal and interest. Normally, loan installments are decided by

banks based the borrower's cash flow capacity. There may be installments paid monthly, quarterly, biannually, or even annually.

4. *Maturity* : Normally a term loan is ranging between 5 to 10 years. Forecasting for more than 10 years in the current changing business environment is very difficult.
5. *Loan Agreement* : An agreement is drafted between the borrower and the bank regarding the terms and conditions of the loans which is signed by the borrower and is preserved with the bank.
6. *Loan Covenant* : Covenants are a part of loan agreement. They are certain statements in the agreement which states about certain do's and dont's for the company.

### Answer 1(c)

Legal as well as contractual requirements have to be followed while framing the dividend policy. All provisions of Companies Act, SEBI Guidelines, Capital impairment guidelines, net profit and insolvency etc. need to comply with while declaring dividend.

Contractual restrictions which are imposed by certain lenders of the firm also affect the dividend policy of a firm as they impose certain conditions about the payment of dividend particularly, during the period when the firm is experiencing liquidity or profitability crisis. In addition, there may be certain internal constraints which affect the dividend policy of a firm; it includes growth prospects, financial requirements, availability of funds, earning stability and control etc.

### **Attempt all parts of either Q. No. 2 or Q. No. 2A**

#### Question 2

- (a) *Equity shares of YMC Corporation has a beta ( $\beta$ ), of 1.4. The risk-free rate is 9%, and the market return is 21%. Determine the risk premium on its equity shares. Further determine cost of equity using the suitable model. (3 marks)*
- (b) *An investor is seeking an efficient portfolio with a correlation of 0.7 between the portfolio and the market and a standard deviation of 2.5%. The market standard deviation is 1.4% and the market rate of return is 16%, a rate that is double the return on risk-free securities. What is the required rate of return being sought by the investor ? (3 marks)*
- (c) *A product requires 40 types of material every day for its manufacturing. A fixed cost of ₹50 per order is incurred for placing an order. The inventory carrying cost for each material is ₹0.02 per day. The lead period is 50 days. Assume 365 days in a year. Calculate the following :*
  - (i) *Economic Order Quantity (EOQ)*
  - (ii) *Re-order Level (ROL).* (3 marks)
- (d) *Calculate the Accounting Rate of Return (ARR) and rank the machine accordingly:*

Particulars	Machine A	Machine B
Initial Investment	₹87,500	₹87,500

*Cash flow after tax*

Year 1	26,250	8,750
Year 2	35,000	26,250
Year 3	43,750	35,000
Year 4	26,250	52,500
Year 5	17,500	35,000

Machine has to be written off over a period of 5 years by straight line method.  
(3 marks)

(e) From the following information, calculate the expected rate of return of a portfolio:

Risk-free rate of return	10%	
Expected return on market portfolio	20%	
Standard deviation of an asset	3%	
Market standard deviation	2.8%	
Correlation coefficient of portfolio with market	0.70	(3 marks)

**OR (Alternate question to Q. No. 2)****Question 2A**

(i) A Private Ltd. Co. has assets worth ₹32,00,000 as on 31st March, 2018 that has been financed as follows :

	₹
Equity Shares of ₹100 each	18,00,000
General Reserve	3,60,000
Debt	10,40,000

For the year ended on 31st March, 2018, the Company's total profits before interest and taxes were ₹6,23,000. The company pays 8% interest on borrowed capital and the tax bracket is 40%. The market value of equity share as on 31st March, 2018 was ₹150 per share.

Calculate the weighted average cost of capital using market value as weights.  
(5 marks)

(ii) The total turnover of X Ltd. is ₹50 lakhs of which 72% is on credit. Debtors are allowed one month to clear off the dues. A factoring company is willing to advance 80% of the bill raised on credit for a fee of 2% a month plus a commission of 10% on the total amount of debts. X Ltd., as a result of this arrangement, is likely to save ₹48,000 annually in management cost and avoid bad debts @ 1% on the credit sales.

A bank has come forward to make an advance equal to 80% of the debts at an annual interest rate of 15%. However, its processing fees will be @ 2% on the debts. Would you accept factoring or the offer from the bank ? (5 marks)

(iii) ABC. Ltd. has a risk free asset yielding 0.02. During this period expected return of 0.09 and a standard deviation of 0.04 are based on past data of the market portfolio. The risk premium 0.07 is considered to be constant throughout the period. A security has a coefficient of correlation with market portfolio of 0.75 and standard deviation is 0.08. The expected standard deviation of market portfolio is now 0.04. On the basis of the given data, find out :

(i) Market's risk return trade-off; and (3 marks)

(ii) Security beta. (2 marks)

### Answer 2(a)

$$\begin{aligned} \text{Risk Premium} &= \text{Market rate of Return } (R_m) - \text{Risk free rate of return } (R_f) \\ &= 21\% - 9\% = 12\% \end{aligned}$$

Cost of Equity ( $K_e$ ) as per CAPM formula

$$K_e = R_f + \beta (R_m - R_f) \text{ where,}$$

$K_e$  = Cost of Equity

$R_f$  = Risk free rate of Return

$\beta$  = Risk Factor

$R_m$  = Market Return

$$\begin{aligned} \text{Hence, Cost of Equity } (K_e) &= 9\% + (21\% - 9\%) 1.4 \\ &= 25.8\% \end{aligned}$$

### Answer 2(b)

#### Calculation of beta co-efficient

Standard deviation ( $\sigma_s$ ) = 2.5%

Correlation co-efficient ( $r_m$ ) = 0.70

Market Standard Deviation ( $\sigma_m$ ) = 1.4%

$$\text{Beta Coefficient} = (r_m \times \sigma_s) \div \sigma_m = (0.70 \times 2.5) \div 1.4 = 1.25$$

$R_m = 16\%$        $R_f = 8\%$

$$\begin{aligned} \text{Required rate of return} &= R_f + \beta (R_m - R_f) \\ &= 8\% + 1.25 (16 - 8) \\ &= 18\% \end{aligned}$$

### Answer 2(c)

$$\begin{aligned} \text{(i) Annual Consumption (A)} &= 40 \text{ types of material} \times 365 \text{ days} \\ &= 14,600 \text{ types of material} \end{aligned}$$

Fixed Cost per order or ordering cost (O) = ₹50

Carrying Cost (C) = 0.02 x 365 days = ₹7.30

$$\text{Economic Order Quantity (EOQ)} = \sqrt{(2AO / C)}$$

A = Annual Consumption = 14,600 types of material

O = Ordering Cost per order = ₹50

C = Carrying Cost = ₹7.30

$$\text{EOQ} = \sqrt{(2 \times 14,600 \times 50) / 7.30} = 447.21$$

- (ii) Re-order level (ROL) = Maximum Usage per day x lead time  
 = 40 types of material per day x 50 days  
 = 2000 types of material

### Answer 2(d)

	<i>Amount in ₹</i>	
Total Cash Flow after Tax (CFAT)	1,48,750	1,57,500
Less : Depreciation (machine has life of 5 years)	(87,500)	(87,500)
Profit after Tax	61,250	70,000
Average Profit after Tax	12,250	14,000

$$\text{Average Rate of Return (ARR)} = \frac{\text{Average Profit after Tax}}{\text{Initial Investment}} \times 100$$

$$\text{Machine A} = \frac{12,250}{87,500} \times 100 = 14\%$$

$$\text{Machine B} = \frac{14,000}{87,500} \times 100 = 16\%$$

Ranking of Machine as per ARR is Machine B : Rank -1  
 Machine A : Rank -2

### Alternate Solution

Based on Average Investment

$$\text{Average Rate of Return (ARR)} = \frac{\text{Average Profit after Tax}}{\text{Average Investment}} \times 100$$

$$\text{Average Investment} = \frac{\text{Initial Investment} + \text{salvage value}}{2}$$

$$= ₹43750 \text{ (for both machines)}$$

$$\text{Machine A} = \frac{12,250}{43,750} \times 100 = 28\%$$

$$\text{Machine B} = \frac{14,000}{43,750} \times 100 = 32\%$$

Ranking of Machine as per ARR is Machine B : Rank -1

Machine A : Rank -2

### Alternate Solution

Year	Machine A			Machine B		
	CFAT	Depreciation	EAT	CFAT	Depreciation	EAT
1	26,250	17,500	8,750	8,750	17,500	(8,750)
2	35,000	17,500	17,500	26,250	17,500	8,750
3	43,750	17,500	26,250	35,000	17,500	17,500
4	26,250	17,500	8,750	52,500	17,500	35,000
5	17,500	17,500	-	35,000	17,500	17,500

$$\text{Average EAT} = 61,250/5 = 12,250$$

Average Investment =  $\frac{1}{2}$  of (Cost of Machine – Salvage Value) + Salvage Value

$$= \frac{1}{2} (87,500 - 0) = 43,750$$

ARR on Initial Investment

$$\frac{\text{Average Profit after Tax}}{\text{Initial Investment}} \times 100$$

$$\text{Machine A} = \frac{12,250}{43,750} \times 100 = 28\%$$

ARR on Average Investment

$$\frac{\text{Average Profit after Tax}}{\text{Average Investment}} \times 100$$

$$= \frac{12,250}{43,750} \times 100 = 28\%$$

Ranking of Machine as per ARR is

$$\text{Average EAT} = 70,000/5 = 14,000$$

Average Investment =  $\frac{1}{2}$  of (Cost of Machine – Salvage Value) + Salvage Value

$$= \frac{1}{2} (87,500 - 0) = 43,750$$

ARR on Initial Investment

$$\frac{\text{Average Profit after Tax}}{\text{Initial Investment}} \times 100$$

$$= \frac{14,000}{43,750} \times 100 = 32\%$$

ARR on Average Investment

$$\frac{\text{Average Profit after Tax}}{\text{Average Investment}} \times 100$$

$$= \frac{14,000}{43,750} \times 100 = 32\%$$

Machine B : Rank -1

Machine A : Rank -2

**Answer 2(e)****Calculation of beta co-efficient**

Standard deviation ( $\sigma_s$ ) = 3%

Correlation co-efficient ( $r_m$ ) = 0.70

Market Standard Deviation ( $\sigma_m$ ) = 2.8%

Beta Coefficient = ( $r_m \times \sigma_s$ )  $\div$   $\sigma_m$  =  $0.70 \times 3 \div 2.8 = 0.75$

$R_m = 20\%$        $R_f = 10\%$

Expected rate of return =  $R_f + \beta (R_m - R_f)$

$R_f$  = Risk free rate of Return

$\beta$  = Risk Factor

$R_m$  = Market Return

=  $10\% + 0.75 (20 - 10)$

= 17.5%

**Answer 2A(i)**

Cost of debt ( $K_d$ ) =  $0.08 (1 - 0.40) = 0.048$  or 4.8%

Cost of equity ( $K_e$ ) = (Earnings per share/market price per share)  $\times$  100

=  $\frac{[(Rs. 6,23,000 - Rs. 83,200)(1 - 0.40)]/18000}{Rs. 150} \times 100$

$\frac{18}{50} \times 100 = 12\%$

**Calculation of WACC (based on market value)**

Source	Amount (₹)	Weight	Specific cost of capital	Weighted specific cost of capital
Equity share capital	22,50,000	0.602	0.12	0.07224
Debt	10,40,000	0.278	0.048	0.01334
General reserves	4,50,000	0.120	0.12	0.0144
	37,40,000	1.00		0.09998

Therefore, the weighted average cost of capital is 0.09998 or 10%

*Note:* Equity share capital and General reserves are divided in the ratio of 5:1 on the basis of their book value.

**Alternative Solution**

<i>Particulars</i>	<i>Amount</i>
EBIT	6,23,000
Less : Interest	(83,200)
EBT	5,39,800
Less : Tax	(2,15,920)
Profit available for equity shareholders	3,23,880

Cost of debt ( $K_d$ )	=	$0.08 (1 - 0.40) = 0.048$ or 4.8%
OR		$83,200 (1-0.4) \div 10,40,000 = 4.8\%$
Cost of equity ( $K_e$ )	=	(Earnings per share/market price per share) x 100
Earning per share	=	$3, 23,880 \div 18,000 = ₹18$ per share
	=	$(18 \div 150) \times 100 = 12 \%$

**Calculation of WACC (based on market value)**

<i>Source</i>	<i>Amount (₹)</i>	<i>Weight</i>	<i>Specific cost of capital</i>	<i>Weighted specific cost of capital</i>
Equity share capital	27,00,000	0.7219	0.12	0.086628
	(₹ 150 x 18000 shares)			
Debt	10,40,000	0.2781	0.048	0.013348
	37,40,000	1.0000		0.099976

$$WACC = 0.099976 \times 100 = 9.998 \% \text{ or } 10\%$$

**Answer 2A(ii)****Cost of Factoring**

Annual Credit Sales	₹50,00,000 x 72 %	₹36 lakhs
Monthly Credit Sales	₹36 lakhs/12	₹3 lakhs
Factor Cost		
Fee (₹3,00,000 x 80%) x 2%		₹4,800
Commission ₹3,00,000 x 10%		₹30,000
	(A)	₹34,800

Less : Savings in Cost:

Management Cost (₹48,000/12)	₹4,000	
Savings in Bad Debts (₹ 3,00,000 x 1 %)	₹3,000	
	(B)	₹7,000
Net Cost of Factoring (per month)	(A-B)	₹27,800
Cost of Bank Advance		
Interest (₹3,00,000 x 80% x 15%) ÷ 12		₹. 3,000
Processing Fee (₹3,00,000 x 2%)		₹6,000
Bad Debts (₹3,00,000 x 1%)		₹3,000
Management Cost		₹4,000
Net Cost (Per Month)		₹16,000

**Since cost of Bank Finance is less than the cost of factoring, therefore, it is advisable to accept bank offer.**

**Answer 2A(iii)**

(i) **Market's risk return trade-off =  $(R_m - R_f) \div \sigma_m$**

Where,  $R_m$  = Market Return

$R_f$  = Risk free rate of Return

$\sigma_m$  = Standard deviation of market

$$= (0.09 - 0.02) \div 0.04 = 1.75$$

(ii) **Security Beta**

$$\beta = (\sigma_s \div \sigma_m) \times r_m$$

where,  $\beta$  = Beta factor of investment

$\sigma_s$  = Standard deviation of investment in security = 0.08

$\sigma_m$  = Market Portfolio standard deviation = 0.04

$r_m$  = Co-efficient of correlation of security with market portfolio = 0.75

$$\beta = (0.08 \div 0.04) \times 0.75 = 1.5$$

**Question 3**

*Differentiate between the following :*

(a) *Forfeiting and Export Factoring*

(b) *Regular dividend policy and Stable dividend policy*

(c) *Net Income Approach and Net Operating Income Approach. (5 marks each)*

**Answer 3(a)****Forfaiting and Export Factoring**

Forfaiting is similar to cross border factoring or export factoring to the extent both have common features of non recourse and advance payment. But they differ in several important respects:

- a. A forfaiter discounts the entire value of the note/bill but the factor finances between 75-85% and retains a factor reserve which is paid after maturity.
- b. The availing bank which provides an unconditional and irrevocable guarantee is a critical element in the Forfaiting arrangement whereas in a factoring deal, particularly non-recourse type, the export factor bases his credit decision on the credit standards of the exporter.
- c. Forfaiting is a pure financing arrangement while factoring also includes ledger administration, collection and so on.
- d. Factoring is essentially a short term financing deal. Forfaiting finances notes/bills arising out of deferred credit transaction spread over three to five years.
- e. A factor does not guard against exchange rate fluctuations; a forfaiter charges a premium for such risk.

**Answer 3(b)****Regular dividend policy and Stable dividend policy**

**Regular dividend policy** : In Regular dividend policy the investors get dividend at usual rate. Here, the investors are usually persons who want to get regularly incomes. This type of dividend payment can be maintained only if the company has regular earning.

Merits of Regular Dividend Policy:

- a. It helps in creating confidence among the shareholders.
- b. It stabilizes the market value of shares.
- c. It helps in marinating the goodwill of the company.
- d. It helps in giving regular income to the shareholders.

**Stable dividend policy** : Here the payment of certain sum of money is regularly made to the shareholders. Constant dividend per share, Constant payout ratio, Stable rupee dividend plus extra dividend are the types of Stable dividend policy.

Merits of stable dividend policy:

- a. It helps in creating confidence among the shareholders.
- b. It stabilizes the market value of shares.
- c. It helps in maintaining the goodwill of the company.
- d. It helps in giving regular income to the shareholders.

**Answer 3(c)****Net income approach and Net operating income approach****Net income approach**

According to this approach there is a relationship between capital structure and the value of the firm and therefore, the firm can affect its value by increasing or decreasing the debt proportion in the overall financial mix. The Net Income Approach makes the following assumptions:

1. The total capital requirement of the firm is given and remains constant.
2. Cost of debt ( $K_d$ ) is less than cost of equity ( $K_e$ ).
3. Both  $K_d$  and  $K_e$  remain constant and any change in financial leverage (i.e., use of more and more debt financing) in the capital structure does not affect the risk perception of the investors.
4. There are no taxes.

**Net operating income approach** is opposite to the Net income approach. According to NOI Approach, the market value of the firm depends upon the net operating profit or EBIT and the overall cost of capital. The financing mix or the capital structure is irrelevant and does not affect the value of the firm. The NOI Approach makes the following assumptions:

- a. The investors see the firm as a whole and thus capitalize the total earnings of the firm to find the value of the firm as a whole.
- b. The overall cost of capital  $K_o$ , of the firm is constant and depends upon the business risk which also is assumed to be unchanged.
- c. The cost of debt,  $K_d$ , is also taken as constant.
- d. The use of more and more debt in the capital structure increases the risk of the shareholders and thus results in the increase in the cost of equity capital i.e,  $K_e$ . The increase in  $K_e$  is such as to completely offset the benefits of employing cheaper debt, and
- e. There are no taxes.

**Question 4**

- (a) *ABC Ltd. is a firm that specializes in providing software services to its clients. In order to augment its time-share computer services to its clients, the firm is considering the purchase of an additional computer.*

*In this context, it has two alternatives, as mentioned below :*

- (i) *Purchasing the computer in lieu of making a payment of ₹24,00,000.*
- (ii) *Entering into a lease agreement with a company with the following necessary terms and conditions :*

- (a) *The computer has to be leased for a period of 3 years for ₹6,00,000 as*

annual lease rent in addition to 15% of the revenue accruing from gross time-share service.

- (b) An additional payment of ₹5,00,000 needs to be done at the end of the third year.
- (c) Payments as lease rent need to be made at the year end.
- (d) After the completion of the specified period in the contract, the computer needs to be handed back to the lessor.

As per the company estimates, the computer under review, presently will have a worth of ₹12 lakhs at the end of the third year with the forecast revenues as follows :

Year	₹
1	24,00,000
2	25,50,000
3	28,00,000

Other relevant details are as follows :

- (i) The Annual operating costs (excluding the depreciation/lease rent of the computer) are ₹10,00,000 as per estimates with an additional ₹2,00,000 being involved in start-up and training costs at the beginning of the first year.
- (ii) The aforesaid costs are to be borne by the lessee ABC Ltd. Further, the lessee will borrow at an interest rate of 15% to finance the acquisition of the computer. Repayments for the same have to be done as per the schedule specified below :

Year-end	Principal (₹)	Interest (₹)	Total (₹)
1	6,00,000	3,60,000	9,60,000
2	9,00,000	2,70,000	11,70,000
3	9,00,000	1,35,000	10,35,000

In order to depreciate its assets, ABC Ltd. employs the straight line method and makes a payment of 50% tax on its income.

You, as a company secretary, are approached by ABC Ltd. to give advice regarding the choice of the more beneficial alternative, with proper and justified reasons.

Consider Present Value Factor at 9%

Year	Present value factor at 9%	Present value factor at 15%
1	0.917	0.870
2	0.842	0.756
3	0.772	0.658

(8 marks)

- (b) Hindustan Chemical Ltd. has operating and capital structure with financial plan A and B under situations I and II. Annual production and sales are 75% of installed capacity.



**Recommendation** : PV of cash outflows under leasing is ₹14,40,512.50 which is more than the PV of cash outflows under buying/borrowing of ₹9,01,040. Therefore, the company is advised to opt buying/borrowing.

Depreciation for 3 years = (₹24,00,000 - ₹12,00,000) = ₹12,00,000; Depreciation per year = ₹4,00,000.

Tax savings on depreciation = 50% of ₹4,00,000 = ₹2,00,000

*Note:* Since the annual operating costs and training costs are same under both the alternatives. Hence, this cost is irrelevant in the decision of purchase or lease. So it is not included in the calculation of cash outflows.

#### Answer 4 (b)

Annual production and sales 75% of 10,000 units installed capacity = 7,500 units

Contribution per unit = Selling price per unit – Variable cost per unit i.e ₹40 - ₹20 = ₹20

Total Contribution is 7,500 x 20 = ₹1,50,000

(Amount is ₹)

	Financial Plan A		Financial Plan B	
	Situation I	Situation II	Situation I	Situation II
Contribution	1,50,000	1,50,000	1,50,000	1,50,000
Less : Fixed Costs	15,000	18,000	15,000	18,000
Operating profit or EBIT	1,35,000	1,32,000	1,35,000	1,32,000
12% Interest on Debt				
On ₹40,000	4,800	4,800	-	-
On ₹30,000	-	-	3,600	3,600
Earnings before tax	1,30,200	1,27,200	1,31,400	1,28,400
Operating Leverage (OL) (Contribution/EBIT)	1.11	1.14	1.11	1.14
Financial Leverage (FL)				
EBIT/EBT	1.04	1.04	1.03	1.03
Combined Leverage (OL x FL)	1.15	1.19	1.14	1.17

#### Highest and least value of combined leverage

##### Highest Value - 1.19 under situation II of Financial Plan A

Situation II of Financial Plan A at 1.19 showing highest risk (both operating risk as well as financial risks are high). As a result any change in sales will have higher impact on EPS.

**Least Value – 1.14 under situation I of Financial Plan B**

Situation I of Financial Plan B at 1.14 showing lowest combined risk (both operating risk as well as financial risks are low). As a result any change in sales will have lesser impact on EPS.

**PART II****Question 5****Case Study :****About the company**

*Black Diamond Ltd. (BDL) is a public limited company in Country-B engaged in mining and production of coal and coal products. The mission of the company is “to be a partner in the economy by producing and fulfilling the energy demand of the country by providing quality coal in economical and sustainable manner”. The company is listed on a stock exchange of the Country B. Shares of the company are held by the Govt. of Country-B, Mutual funds & FII and general public in proportion of 75%, 12% and 13% respectively. During the financial year 2018-19, the company has produced and dispatched 500 million tonnes of coal. Of this 76% to power plants, 2% to steel plant and rest to other sectors.*

*Coal is the prime source of energy and fulfills approx. 70% of energy demand of the country B. The thermal power plants, steel manufacturing plants, cement and fertilizer plants are the major consumers of coal.*

*The country-B has a large reserve of coal but the quality and cost are major concern. In the last few years there has been increase in import of coal by steel and power plants. The steel plants import coal due to quality and cost advantage over domestic coal. As per a study report conducted by the BDL, good quality of coal can be produced only through deep and underground mining. Underground mining requires highly automated technology.*

**Challenges before BDL**

*For adopting deep underground mining the BDL is required to acquire land for new mines and latest automated machines for mining. Land acquisition in country-B has been a hard task due to land acquisition related laws and protests by the local community and NGOs as BDL has acres of idle land in the form of used abandoned mines which cannot be used for agricultural activities or human rehabilitation due to the risk of landslides. BDL is a labour intensive company with low productivity. Employee cost is the major cost of BDL which accounts for 55% of total cost. BDL is second largest employer in country B.*

*Till recent past, the BDL was the only company which was allowed for mining and marketing of the coal in the country but with the changing economic scenario and to meet the growing energy demand the Govt. of Country-B is mulling to allot coal blocks to steel plant and thermal power plant for captive consumption.*

*The Govt. of the Country B is committed to boost manufacturing and industrial infrastructure of the country in next 10 years. Power and steel sector would be*

witnessing a multifold increase in demand not only from Govt. schemes but also from private and domestic consumers.

To meet the energy demand, the Govt. has reduced the duty on imported coal. The Govt. being a signatory of Paris agreement on climate change, is committed for sustainable development by reducing carbon emission caused by usage of fossil fuels. It has entered into various technological MoUs to install clean energy sources like nuclear, solar and wind in near future.

Required :

- (i) Identify and describe the five forces of Porter with respect to BDL.
- (ii) Identify the stakeholders in BDL. Discuss the strategy which BDL should adopt to prioritise the stakeholders.
- (iii) Explain the strategy BDL should adopt to survive and gain competitive advantage.
- (iv) Prepare a SWOT analysis for BDL.
- (v) If BDL wants to change itself from a labour intensive organization to a modern technology driven organization, state how BDL can manage the resistance to change from employees related unions ? (4 marks each)

#### Answer 5(i)

The five forces model which was created by Michael Porter is an analytical tool that uses industry forces that uses five industry forces to determine the intensity of competition in an industry and its profitability level. The five forces in present case of BDL is described as under:

- a. *Industry Rivalry/Competition (Low)*  
Industry rivalry for the BDL is low as it is the only company which is allowed for mining and marketing of the coal in the country and most of the energy requirement of the country is fulfilled by coal. However, increase in import along with reduced import duty may be a potential threat.
- b. *Threat of New Entrants (Medium/high)*  
With the changing economic scenario and to meet the growing energy demand the Govt. of Country B is mulling to allot coal blocks to steel plant and thermal power plant for captive consumption which may be a cause of worry for BDL in near future.
- c. *Threat of Substitutes (Low)*  
At present, coal is the prime source of energy and fulfills approx. 70 % of energy demand of the country B. There are various substitutes of coal like Natural gas, solar, wind, nuclear energy etc. Since the Government of country B is a signatory of Paris agreement on climate change and entered technological MoUs to install clean energy sources like nuclear, solar and wind energy, the threat of substitutes may increase in future.
- d. *Bargaining power of buyers (Low/Medium)*  
The thermal power plants, steel manufacturing plants, cement and fertilizer

plants are the major customers of BDL. At present, there is no other alternative available with the customer as the BDL is the only coal producing and marketing company. But in near future bargaining power of buyer may increase as the Govt. of country B is mulling to allot coal blocks to steel and thermal power plant.

e. *Bargaining power of suppliers (Medium/High)*

Being labour intensive company, suppliers of consumables, work contractors and the employees can be classified as suppliers for BDL. When the technology will change, power of supplier who are supplying for specific parts for heavy machineries, explosive and power etc. may increase.

**Answer 5(ii)**

Stakeholders in BDL are as under:

- Investors (Government, Mutual Funds and FII and General Public)
- Customers i.e thermal power plants, steel manufacturing plants, cement and fertilizer plants
- Suppliers
- Employees of BDL, Union and Associations
- Regulators as Administrative body (Ministry of Mines, Ministry of Environment, Forest and Climate Change, Ministry of Labour and Employment)

**Prioritising of Stakeholders**

- BDL should give priority to Regulators who have financial, regulatory and positional powers to allot coal blocks to other companies and can influence the business of company.
- Being the labour intensive company, employees of BDL should be second priority and be satisfied as the functioning of the company is totally dependent on them.
- Customers should also be then prioritised because in changing economic scenario and to meet the growing energy demand, the Government may allot coal blocks to others for captive consumption.
- Further, suppliers should also not be ignored as the functioning of company is dependent on them by providing the supplies. Last but not the least, the stakeholders who are neither having excessive interest nor power to influence should be monitored for their action and handles appropriately.

**Answer 5(iii)**

BDL should adopt the Porter's Generic Strategies i.e Cost leadership, Product differentiation and Focus on Niche, which are described below:

**Cost Leadership Strategy** : BDL being the leader in its market should adopt the cost leadership strategy. Power plants are main customers of BDL. Keeping this in view the quality of coal, power plants are importing coal from last few years. It is necessary

to maintain the power plant customers by providing the good quality coal by using highly automated technology. Initially, it may require high capital investment but it will offer the various benefits like decreasing the total production cost, maintaining of customers, less pollution, low manpower cost etc.

**Product Differentiation Strategy :** BDL can produce the good quality coal through deep and underground mining using highly automated technology. In view to meet the government commitment for sustainable development by reducing carbon emission caused by usage of fossil fuels, the company may enter in to solar and wind energy production on idle abandoned land.

**Niche/ Focus Strategy :** Company may also use focus strategy to meet the unique requirements of company like quality coal which consist of 76 % of total customer base, which is only possible by installing highly automated machine for creating competitive advantage.

#### Answer 5(iv)

#### SWOT Analysis for BDL

<i>Strengths</i>	<i>Weaknesses</i>	<i>Opportunities</i>	<i>Threats</i>
<ul style="list-style-type: none"> <li>• Monopoly in domestic market</li> <li>• Strong coal demand</li> <li>• Government backed organisation with 75% shares</li> <li>• Rich experience in mining</li> <li>• Being listed entity, it can raise more funds from market for technology upgradation</li> </ul>	<ul style="list-style-type: none"> <li>• Labour intensive company</li> <li>• Bad Quality of coal for power plant which is 76% of customer base</li> <li>• High cost of production</li> <li>• Lack of highly automated technology</li> </ul>	<ul style="list-style-type: none"> <li>• Country has large reserve of coal</li> <li>• Extracting good quality coal through deep mining</li> <li>• Abandoned land for diversification i.e solar and wind energy</li> <li>• Planning of government to boost manufacturing and industrial infrastructure</li> </ul>	<ul style="list-style-type: none"> <li>• Increasing demand of quality control by steel and power plants which is presently not available with BDL.</li> <li>• Government plan to allot coal blocks to steel and thermal power plant may reduce consumption of coal provided by BDL.</li> <li>• The government commitment to promote non-conventional energy will hamper the coal demand in future.</li> <li>• Employee cost with low productivity can be a big threat due to lack of competitive advantage.</li> </ul>

#### Answer 5(v)

BDL can manage the resistance to change from employees related unions by following ways:

- i. *Education and Communication* : If misinformation and lack of information create barriers to managing change, education and communication might be appropriate. It requires an atmosphere of mutual trust and confidence and respect between managers and employees.
- ii. *Participation* : Participation helps to give people in organizational change a feeling of importance. It creates the feelings among the employees that the decision is their own. They realise that the change process is a must.

- iii. *Obtaining commitment* : Commitment to take part in changed programme can be obtained on one to one basis from employees. However, getting a person to commit himself in private to a changed programme may yield fewer results than if he voluntarily and publicly gives his commitment to an idea of change.
- iv. *Leadership* : A transformational leader can use personal reasons for change without arousing resistance. An effective leader tries to change the psychological needs of his followers.
- v. *Training and Psychological Counselling* : Management can change the basic values of the people by training and psychological counselling. People should be educated to become familiar with change, its process, and working.
- vi. *Coercion or Edict* : Coercion or edict is the imposition of change or the issuing of directives about change. It is the explicit use of power. Coercion is the least successful style of managing change except in a state of crisis or confusion.

**Attempt all parts of either Q. No. 6 or Q. No. 6A**

**Question 6**

- (a) *'Planning is the blue print of future course of action'. Discuss with the significance of planning.*
- (b) *'A company secretary in today's era while discharging his/her professional obligation has to perform several key roles which are also integral components of strategic management'. Discuss briefly about compliance and representation roles.*
- (c) *'Logistics strategy plan is an important part of formulation of strategy'. What are the major elements of Strategy Plan ?*
- (d) *'Despite various advantages, divisional structure form of organisation has certain disadvantages'. Discuss, highlighting major disadvantages. (5 marks each)*

**OR (Alternate question to Q. No. 6)**

**Question 6A**

*Comment on the following :*

- (i) *Logistics is not confined to tactical decision about transportation and warehousing.*
- (ii) *An effective implementation of strategy in an organisation needs multiple supporting factors.*
- (iii) *Porter has pronounced three generic strategies, namely "Cost Leadership", "Differentiation", and "Focus".*
- (iv) *Behavioural implementation is concerned with those aspects of strategy implementation which have influence on the behaviour of the people in the organisation.*
- (v) *Failure of a firm is technical if it is unable to meet its current obligations. (4 marks each)*

**Answer 6(a)**

Planning is significant because the planning provides the organization a better sense of what it wants to achieve and how to achieve it. In effect, planning ensures the proper utilization of the available resources and the capability to comprehend how these should be used in order to achieve the goal. A key part of planning is also the vital role it plays in pacifying risks. When management plans for the tasks ahead, they are looking at the situation and detailing the probable difficulties ahead.

**Answer 6(b)**

A company secretary in today's era while discharging his or her professional obligations has to perform several key roles which are also integral components of strategic management. A brief on compliance and representation roles is as follows:

*Compliances role* : In current scenario a business has to adhere to various laws and regulations failing which may invite various legal hassles. A company secretary is required to ensure compliance with various laws and regulations and for doing so he / she should be conversant with the laws as well as the amendments that take place. For instance, in Indian context a company secretary has to ensure compliances of the following laws but not limited to- Companies Act; SEBI Act, Securities Contracts (Regulation) Act and rules and regulations made there under; Foreign Exchange Management Act; Consumer Protection Act; Depositories Act; Environment and Pollution Control Laws; Labour and Industrial Laws etc.

*Representation role* : A Company Secretary has to represent before various tribunals and courts in order to present the legal issue of the company. In India, a Company Secretary appears before the following legal bodies- National Company Law Tribunal (NCLT); National Company Law Appellate Tribunal (NCLAT); Competition Commission of India (CCI); Registrar of Companies; Tax Tribunals etc.

**Answer 6(c)**

Major elements of Logistics Strategy plan are as under:

1. *Customer service policy* – the appropriate level of service for customers, by product group or market segment; considering order fulfillment requirements, enquiry and investigation capability and the available information. The customer service policy informs the nodes and links of the supply network
2. *Inventory location policy (Supply Network nodes)* – Centralized or decentralized inventory; whether to differentiate facilities by fast and slow moving stock; location of sites; use of specific technologies and layouts; company-owned or contracted facilities etc.
3. *Inventory policy* – Form and function of inventory by location; the appropriate amount of stock to hold for various groups of inventory; planning structure that links outbound and inbound materials
4. *Cost plan* – Trade-off analysis between cost and service level requirements; cost of Logistics operations
5. *Transport and distribution (Supply Network links) policy* – affected by whether

enterprise imports or exports and the size and structure of conurbations being served. This incorporates transport modes, delivery pattern and storage location considerations, based on the time taken for deliveries.

6. *IT and Communications capability*: Technologies (including software) that will be internally developed; buy planning and scheduling applications from single supplier or obtain 'best of breed' applications.
7. *Logistics organisation structure*: Function or flow based; allocation of responsibilities and managed or self-managed teams
8. *Logistics Targets and metrics*: Measures of performance and achievement targets; operations improvements process and management.

#### **Answer 6(d)**

Despite various advantages, divisional structure form of organization has certain disadvantages also. Some of them are as under:

- i. *Costly affair*: It incurs extra costs since each division has its own set of functional departments and attached staff.
- ii. *Competition between divisions*: Divisionalisation and compartmentalization leads each division to compete for more resources leading to competition among the divisions due to which one department suffers at the cost of another.
- iii. *Coordination problem*: It is difficult to manage as a result of more divisions and departments
- iv. *Change of priorities*: The service departments such as research and development in order to get higher and quick returns on investments.

#### **Answer 6A(i)**

Logistics is not confined to tactical decisions about transportation and warehousing. Longer-term decisions are needed to put in place the capabilities that ensure that logistics plays a full role in supporting a company's products in the market place. When a company creates a logistics strategy it is defining the service levels at which its logistics organization is at its most cost effective. Because supply chains are constantly changing and evolving, a company may develop a number of logistics strategies for specific product lines, specific countries, or specific customers. Apart from transportation and warehousing, logistics strategy deals with the following:

- Sources of Raw material and Components available
- Number of Manufacturing locations, and the products manufactured therein
- Nature of material handling equipments used
- Nature of distribution facilities
- Method for deploying inventory in the logistics network

#### **Answer 6A(ii)**

The development and selection of strategies to pursue in an organization is considered easier and less time consuming than implementing these strategies once they have

been chosen. An effective implementation of strategy in an organization needs multiple supporting factors, which are as under:

- i. *Action Planning* - Organizations to be successful in strategy implementation need to develop a detailed action plan i.e., chronological lists of action steps (tactics) which add the necessary details to strategies and assign responsibility to specific individual or group for accomplishing those actions.
- ii. *Organizational Structure* - Successful strategists should also give proper thought to their organizational structure and see whether the current structure is appropriate for their intended strategy because different structures suit the implementation of different strategies
- iii. *Human Resource Factors* - Human Resource factors through framing strategic plan play a vital role in successful implementation of strategies in an organization. The consideration of human resources requires the management to think about the organization's communication needs. Further, managers successful at implementation of different strategies are aware of the effects of each new strategy that will have on their human resource needs.
- iv. *Annual Business Plan* - Organizations successful at implementation are well aware of their need to fund their intended strategies.
- v. *Monitoring and Control* - Monitoring and controlling the plan covers a list of options to get back on course if company should veer off.

#### **Answer 6A(iii)**

Michael Porter pronounced the three generic strategies namely “Cost Leadership” (no frills), “Differentiation” (creating uniquely desirable products and services) and “Focus” (offering a specialized service in a niche market).

*The Cost Leadership Strategy* - This strategy also involves the firm winning market share by appealing to cost-conscious or price-sensitive customers. This is achieved by having the lowest prices in the target market segment, or at least the lowest price to value ratio (price compared to what customers receive).

*The Differentiation Strategy* - A differentiation strategy is appropriate where the target customer segment is not price-sensitive, the market is competitive or saturated, customers have very specific needs which are possibly under-served, and the firm has unique resources and capabilities which enable it to satisfy these needs in ways that are difficult to initiate.

*The Focus Strategy* - The focus strategy is also known as ‘niche’ strategy. This is so because, companies adopt focus strategies, focus on niche markets and, by get hold of the dynamics of such niche market and unique requirements of its customers. Based on such understanding, they develop exclusively low-cost products particularly for such niche market. Due to this, a strong brand loyalty is developed with its customers making it difficult for competitors to enter.

#### **Answer 6A(iv)**

Since the organization is basically a deliberate creation of human beings for certain

specified objectives, the activities and behavior of its members need to be directed in certain way. Some of the issues which are relevant for behavioural implementation of strategy in an organization are as under:

*Leadership* - Leaders are the vital aspect of an organization which helps to cope with the changes by ensuring that plans and policies are formulated and implemented as desired. Leadership is basically the ability to persuade others to achieve the defined objectives willingly and enthusiastically. A strategic leadership involves the process of transforming an organization with the help of its people so as to put it in a unique position.

*Organizational Culture* - Organizational culture affects strategy implementation as it provides a framework within which the behavior of the members takes place. It is defined as a set of assumptions, beliefs, values and norms which are shared by people and groups in the organization and control the way they interact with each other and with stakeholder outside the organization.

*Values and Ethics* - Values are convictions and a framework of philosophy of an individual on the basis of which one would judge what is good or bad. Business ethics generates from: (a) value forming institutions; (b) organizational values and goals; (c) colleagues; and (d) professional code of conduct.

#### **Answer 6A(v)**

Failure of a firm is technical if it is unable to meet its current obligations. The failure could be temporary and might be remediable. When liabilities exceed assets i.e. the net worth becomes negative, resulting into bankruptcy. Technical bankruptcy can be ascertained by comparing current assets and current liabilities i.e. current ratio or quick ratio. A negative working capital indicates that short term borrowings be used for financing long term assets which may lead to insolvency in future. For example, a high level of interest payment due to high proportion of debt in the capital structure it may result into inadequate cash flows. If the situation persists for a long time may result in financial crises due to pressure from creditors and creditors would take their loan back from the company. It will impact the share price of the company also as investors will withdraw their funds. In short, company may find itself in the situation of financial distress.

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