Paper-11 Capital Market Analysis & Corporate Laws

Time Allowed: 3 hours **Full Marks: 100**

Working notes should form part of the answers.
Wherever necessary, suitable assumptions should be made and indicated in answer by the candidates.

Section I
(Capital Market Analysis)

Answer **Question No.1** (carrying 20 marks) which is compulsory and answer **any two** (carrying 20 marks each) from the rest in this section

Question 1.

(a) In each of the cases given below, one out of four is correct. Indicate the correct answer (=1 mark) and give workings/ reasons briefly in support of your answer (=1 mark) [7 x 2]

(i) **Zenion Ltd. issued right shares that increased the market value of the shares of the company by ₹ 180 crore. The existing base year average is ₹ 750 crore. If the aggregate market value of all the shares included in the index before the right issue made is ₹ 1200 crore, what will be the new base year average?**
(A) ₹ 782.30 crore;
(B) ₹ 862.50 crore;
(C) ₹ 978.20 crore;
(D) Insufficient information.

(ii) **The Co-efficient of Correlation between returns of Moonshine Ltd. and SENSEX is 0.98. The expected returns on the stock of Moonshine Ltd. and SENSEX are 16% and 13.77% respectively. The return on 182 day T-Bill is 6.35%. If the standard deviation of the returns of Moonshine Ltd. is 21%, what would be the standard deviation of SENSEX's return?**
(A) 15.83%;
(B) 16.51%;
(C) 22.42%;
(D) None of (A), (B), (C).

(iii) **Consider the following data of Sun India Mutual Fund (Growth Plan):**

Particulars	₹ in crore
Value of investments	2,757.00
Receivables	221.00
Other current Assets	643.00
Liabilities	390.00
Accrued Expenses	87.00

If the number of outstanding units is 155 crore and sales charge is 2.20% on the NAV, the public offering price will be:
(A) ₹ 21.41;
(B) ₹ 20.81;
(C) ₹ 20.74;
(D) Insufficient information.

(iv) Ureka Ltd. has an excess cash of ₹ 9,00,000 which it wants to invest in short-term marketable securities. Expenses relating to investment will be ₹ 21,000. If the securities invested will have an annual yield of 10%, what would be the period of investment so as to earn a pre-tax income of 6%? (Ignore time value of money)
(A) 6.50 months;
(B) 9.50 months;
(C) 10.00 months;
(D) Insufficient data.

(v) Petronet Ltd. has both European Call and Put options traded on NSE. Both options have an expiration date of 6 months and exercise price of ₹ 40. The call and put are currently selling for ₹ 12 and ₹ 5 respectively. If the risk-free rate of interest is 8% p.a., what would be the stock price of Petronet Ltd? [Given PVIF $_{8\%,0.5\ yr.}$ = 0.9615]
(A) ₹ 55.46;
(B) ₹ 45.46;
(C) ₹ 31.46;
(D) None of (A),(B), (C).

(vi) The Stock of Ventex Ltd. (FV ₹ 10) quotes ₹ 920 on NSE and the 3 months futures price quotes at ₹ 950 and borrowing rate is given as 8% p.a. If the expected annual dividend yield is 15% p.a. payable before expiry, then the theoretical price of 3 month Ventex Ltd. Futures would be:
(A) ₹ 948.80;
(B) ₹ 939.90;
(C) ₹ 928.40;
(D) ₹ 936.90.

(vii) The NAV of each unit of a closed-end fund at the beginning of the year was ₹ 18. By the end of the year its NAV equals ₹ 18.50. At the beginning of the year each unit was selling at a 2% Premium to NAV and by the end of the year each unit is selling at a 4% discount to NAV. If the closed-end fund paid year end distribution of income of ₹ 2.50 on each unit, the rate of return to the investor in the fund during the year would be:
(A) 10.35%;
(B) 11.51%;
(C) 11.95%;
(D) None of the above.

(b) Choose the most appropriate one from the stated options and write it down: [6×1]

(i) An investor has received bonus shares from Albuno Ltd., a listed company, in the ratio of 1:2. After the receipt of bonus shares:
(A) There is no change in stockholding and it remains the same;
(B) There is no change in stockholding, but more shares available for trading;
(C) Stockholding has gone up with more shares available for trading;
(D) Stockholding has gone up.

(ii) Arbitrage pricing theory model helps to:
(A) Reduce risk;
(B) Eliminate arbitrage;
(C) Identify the equilibrium asset price;
(D) None of the above.

(iii) A process of investment by a Sponsor or a Syndicate of Investors/Sponsors directly in a Company is referred as:
(A) Bought out deal;
(B) Buy back of shares;
(C) Irredeemable preference shares;
(D) Deferred shares.

(iv) Following is not a Money Market Instrument:
(A) Treasury Bill;
(B) Certificate of Deposit;
(C) Equity Shares;
(D) Commercial Paper.

(v) Markowitz Mean-Variance Model is used in:
(A) Modern Portfolio Analysis;
(B) Traditional Portfolio Analysis;
(C) Modern Capital Market Analysis;
(D) None of the above.

(vi) As per SEBI'S guidelines, a mutual fund should be established as a:
(A) Public Limited Company;
(B) Trust;
(C) Private Limited Company;
(D) None of the above.

Answer to 1(a):

(i) B: 862.50 crore

New Base year Average:

Old Base Year Average × $\frac{\text{(New Market Value)}}{\text{Aggregate Market Value}}$

= ₹ [750 × (1200 + 180) ÷ 1200] crores = ₹ 862.50 Crore

(ii) A: 15.83%

$0.16 = R_F + (R_M - R_F)\beta = 0.0635 + (0.1377 - 0.0635) \times \beta$

Or, $\beta = 0.0965 \div 0.0742 = 1.30$

Again $\beta = (\sigma_M \, \rho_{Mm}) / \sigma_m$

Or, $\beta\sigma_m = \sigma_M\rho_{Mm} = 0.21 \times 0.98$

Or, $1.30\sigma_m = 0.2058$ Or $\sigma_m = 0.1583$ i.e. 15.83%.

(iii) C: ₹ 20.74

$$\text{NAV} = \frac{\text{Total Current Assets - Total Current Liabilities}}{\text{No of Outstanding Units}}$$

$$= \frac{₹(2757 + 221 + 643) - (390 + 87)\text{ crores}}{155\text{ crores}} = ₹\ 20.284$$

$$\text{Public Offering Price} = \frac{20.284}{1 - 0.022} = \frac{20.284}{0.978} = ₹\ 20.74$$

(iv) **C: 10.00 months**
Pre- tax income required in investment of ₹ 900000
= ₹ 900000 × 0.06 = ₹ 54,000
Let the period of investment be "P"

$\therefore\ (900000x0.10x\frac{p}{12})$ - 21000 = 54000

Or, 7500 P = 54000 + 21000 = 75000
Or, P = 75000 ÷ 7500 = 10.00 months

(v) **B: ₹ 45.46**
According to Call-Put Parity
$C_o = P_o + S_o - PV\ (E)$
$12 = 5 + S_o - 40 \times 0.9615$
$\therefore S_o = 12 - 5 + 38.46 =$ ₹ 45.46

Where $C_o = 12$, $P_o = 5$
PV (E) = PV of Exercise Price
S_o = Stock Price

(vi) **D: ₹ 936.90**
Future Price = Spot Price + Costs of Carrying - Dividend
= 920 + 920 × 0.08 × 3/12 – 10 × 0.15
= 920 + 18.40 - 1.50 = ₹ 936.90

(vii) **A: 10.35%**
The price of unit at the beginning of the year —
₹ 18 × 1.02 = ₹ 18.36
The price of unit at the end of the year —
₹ 18.50 × (1–.04) = ₹ 17.76
The price of the fund fell by (₹ 17.76 – ₹ 18.36) = ₹ - 0.60
Rate of return = ₹ (2.50-0.60) ÷ ₹ 18.36 = 10.35%

Answer to 1(b):

(i) B. There is no change in stockholding, but more shares available for trading
(ii) C. Identify the equilibrium asset price
(iii) A. Bought out deal
(iv) C. Equity Shares
(v) A. Modern Portfolio Analysis
(vi) B. Trust

Question 2.

(a) Ms. Kritika, an investor, has invested in three Mutual Fund Schemes as per listed below:

Particulars	MF – SG	MF – BN	MF - ZN
Date of Investment	**01.12.2013**	**01.01.2014**	**01.03.2014**
Amount of Investment	**₹ 15,00,000**	**₹ 5,00,000**	**₹ 3,00,000**
Net Asset Value (NAV) at entry date	**₹ 10.50**	**₹ 10.25**	**₹ 10.10**
Dividend received upto 31.03.2014	**₹ 25,000**	**₹ 8,000**	**NIL**

NAV as at 31.03.2014	**₹ 10.40**	**₹ 10.30**	**₹ 9.90**

Required:
What is the effective yield on per annum basis in respect of each of the three schemes to Ms. Kritika upto 31.03.2014.
Take one year = 365 days, (Ignore time value of money)
Show calculations upto two decimal points.

(b) What do you mean by Underwriting? State the different types of methods of Underwriting. Also lit out the advantages of Underwriting.

(c) Mr. Venkataraman's portfolio consists of six securities. The individual returns of each of the security in the portfolio is given below:

Security	Proportion of investment in the portfolio	Return
Wipro	10%	18%
Latham	25%	12%
SBI	8%	22%
ITC	30%	15%
RNL	12%	6%
DLF	15%	8%

Calculate the weighted average of return of the securities consisting the portfolio.
[6+(2+3+5)+4]

Answer:

(a) Calculation of Effective Yield on Per Annum Basis in respect of three Mutual Fund Schemes to Ms. Kritika up to 31.03.2014

	Particulars / Schemes	MF-SG	MF-BN	MF-ZN
1	Investment (₹)	15,00,000	5,00,000	3,00,000
2	Unit NAV at entry date (₹)	10.50	10.25	10.10
3	Nos. of Units (Investment / NAV at entry date)	1,42,857.14	48,780.49	29,702.97
4	Unit NAV at 31.03.2014 (₹)	10.40	10.30	9.90
5	Total NAV 31.03.2014 (₹)	14,85,714.26	5,02,439.05	2,94,059.40
6	Increase / Decrease of NAV (1- 5) (₹)	(14,285.74)	2,439.05	(5,940.60)
7	Dividend Received (₹)	25,000.00	8,000.00	NIL
8	Total yield Change in NAV + Dividend (₹)	10,714.26	10,439.05	(5,940.60)
9	Number of days	121	90	31
10	Effective Yield (% p.a.) [(Total Yield / Investment) x (365 / No. of days) x 100]	2.15%	8.47%	(23.32%)

(b) Underwriting: Underwriting is an agreement whereby the underwriter promises to subscribe to a specified number of shares or debentures or a specified amount of stock in the event of public not subscribing to the issue. If the issue is fully subscribed then there is no liability for the underwriter. If a part of share issues remain unsold, the underwriter will buy the shares. Thus underwriting is a guarantee for the marketability of shares.

Method of underwriting: An underwriting agreement may take any of the following three forms:

1. **Standing behind the issue:** Under this method, the underwriter guarantees the sale of a specified number of shares within a specified period. If the public do not subscribe to the specified amount of issue, the underwriter buys the balance in the issue.

2. **Outright purchase:** The Underwriter, in this method, makes outright purchase of shares and resells them to the investors.

3. **Consortium method:** Underwriting is jointly done by a group of underwriters in this method. The underwriters form a syndicate for this purpose. This method is adopted for large issue.

Advantages of underwriting: Underwriting assumes great significance as it offers the following advantages to the issuing company:

1. The issuing company is relieved from the risk of finding buyers for the issue offered to the public. The company is assured of raising adequate capital.

2. The company is assured of getting minimum subscription within the stipulated time, a statutory obligation to be fulfilled by the issuing company.

3. Underwriters undertake the burden of highly specialized function of distributing securities.

4. Provide expert advice with regard to timing of security issue, the pricing of issue, the size and type of securities to be issued etc.

5. Public confidence on the issue enhances when underwritten by reputed underwriters.

(c) **Calculate the weighted average of return of the securities**

Security	Weight (W)	Return (%) (R)	(W X R)
Wipro	0.10	18	1.80
Latham	0.25	12	3.00
SBI	0.08	22	1.76
ITC	0.30	15	4.50
RNL	0.12	6	0.72
DLF	0.15	8	1.20
Total			**12.98**

So, portfolio return is 12.98%.

Question 3.

(a) A stock that pays no dividends is currently selling at ₹ 100. The possible prices for which the stock might sell at the end of one year with associated probabilities are:

End of year price	Probability
₹ 90	**0.1**
₹ 100	**0.2**
₹ 110	**0.4**
₹ 120	**0.2**

₹ 130	0.1

(i) Calculate the expected rate of return by year end,
(ii) Calculate the standard deviations of the expected rate of return.

(b) A prospective investor has collected the following information pertaining to returns on stocks A & B.

Stock	Correlation Coefficient (with market)	Standard Deviation	Expected Return
A	0.6	0.3	0.12
B	0.4	0.2	0.11

Expected market return = 0.10
Risk free rate of return = 0.06
Variance of market return = 0.01

You are required to find out:

(i) The beta for an equally weighted portfolio of stocks A & B.
(ii) The required rate of return as per CAPM for portfolio of 50% each of A & B.
(iii) Are A & B are under-priced, overpriced or correctly priced according to CAPM?

(c) Describe the various risks associated with derivatives?

(d) Mention few services which are offered by a merchant bank. Write the distinctions between merchant banks and commercial banks.

[4+(3+1+3)+4+(2+3)]

Answer:

(a)

(i)

Probability	0.1	0.2	0.4	0.2	0.1
Return	-10	0	10	20	30

E (R) = 0.1 (-10) + 02. (0) + 0.4 (10) + 0.2 (20) + 0.1 (30)

= -1.0 +0 +4.0 +4 +3.0

= 10.0%

(ii) σ^2 = [0.1 (-10-10)^2 + 0.2 (0-10)^2 + 0.4 (10-10)^2 + 0.2 (20-10)^2 + 0.1 (30-10)^2]

σ = 10.95%.

(b)

(i) Beta of a stock is given by $\beta_i = \rho_{im} \times \dfrac{\sigma_i \sigma_m}{\sigma^2{}_m}$

Were, ρ_{im} = Correlation coefficient of the stock with the market

σ_i = Standard deviation of the stock returns

σ_m = Standard deviation of market returns

Let's β_A, β_B and β_{AB} be the beta of stock A, stock B and portfolio of stock A & B in equal proportion.

$$\beta_A = 0.6 \times \frac{0.3}{\sqrt{0.01}} = 1.8$$

$$\beta_B = 0.4 \times \frac{0.2}{\sqrt{0.01}} = 0.8$$

$$\begin{aligned} \beta_{AB} &= 0.5\,\beta_A + 0.5\,\beta_B \\ &= 0.5 \times 1.8 + 0.5 \times 0.8 \\ &= 1.3 \end{aligned}$$

(ii) According to CAPM the equilibrium required rate of return is given by

$$R_P = R_f + \beta_P (R_m - R_f)$$

$$\begin{aligned} \text{Here, } R_m &= 0.10 \\ \beta_P &= \beta_{AB} = 1.3 \\ R_f &= 0.06 \\ R_P &= 0.06 + 1.3(0.10 - 0.06) \\ &= 0.112 \\ &= 11.2\% \end{aligned}$$

(iii) Required rate of return for stock A

$$\begin{aligned} R_A &= R_f + \beta_A (R_m - R_f) \\ &= 0.06 + 1.8\,(0.10 - 0.06) \\ &= 0.132 \\ &= 13.2\% \end{aligned}$$

The expected rate of return from stock A is 12% therefore security is overpriced.

Required rate of return for Stock B

$$\begin{aligned} R_B &= R_f + \beta_B (R_m - R_f) \\ &= 0.06 + 0.8\,(0.10 - 0.06) \\ &= 0.092 \\ &= 9.2\% \end{aligned}$$

The expected rate of return from B is 11%, therefore security is under priced.

(c) Various risks associated with derivatives are as follows:

(i) **Market Risk –** Price sensitivity to fluctuations in interest rates and foreign exchange rates.

(ii) **Liquidity Risk –** Most derivatives are customized instruments, hence may exhibit substantial liquidity risk.

(iii) **Credit Risk –** Derivatives trades not traded on exchange are traded in the Over the Counter (OTC) markets. OTC contracts are subject to counter party defaults.

(iv) **Hedging Risk –** Derivatives are used as hedges to reduce specific risks. If the anticipated risks do not develop, the hedge may limit the funds total return.

(v) **Regulatory Risk –** Owing to the high risk characteristics inherent in the derivatives market, the regulatory controls is sometimes too oppressive for market participants.

(d) Few services which are offered by a merchant bank:

1. Corporate counselling,
2. Project counselling,
3. Loan syndication,
4. Issue management:
   - Public issue through prospectus
   - Marketing
   - Pricing of issues
5. Underwriting of public issue,
6. Portfolio management.

The distinctions between merchant banks and commercial banks are summarized below:

1. Commercial banks basically deal and debt related finance and their activities are appropriately arrayed around credit proposal, credit appraisal and loan sanctions. On the other hand, the area of activities of merchant bankers is "equity and equity related". They deal with mainly funds raised through money market and capital market.
2. Commercial banks are asset oriented and their lending decisions are based on detailed credit analysis of loan proposals and the value of security offered against loans. They generally avoid risks. The merchant bankers are management oriented. They are willing to accept risk of business.
3. Commercial bankers are merely financiers. The activities of merchant bankers include project counselling, corporate counselling in areas of capital restructuring, amalgamations, mergers, takeover etc, discounting and rediscounting of short term paper in money markets, managing, underwriting and supporting public issues in new issue market and acting as brokers and advisers on portfolio management in stocks exchange. Merchant banking activities have impact on growth, stability and liquidity of money markets.

Question 4.

(a) An investor has the following position on options of ONGC:

(i) Long one call option with a premium of ₹ 25 per stock at an exercise price of ₹ 400.

(ii) Long one put option with a premium of ₹ 5 per stock at an exercise price of ₹ 300.

The prevailing market price of the ONGC is ₹ 350. Options are European options with expiration period of 3 months.

You are required to find out the profit or loss to the investor in the following market situations:

(i) At expiration if the price of the ONGC remained at present level.
(ii) At expiration if the price of the ONGC rises to ₹ 500.
(iii) At expiration if the price of the ONGC falls to ₹ 250.

(b) What do you mean by Exchange Traded Funds (ETF)? State the applications of it.

(c) Shares of Vinani Ltd. has a beta factor of 1.8. The NIFTY has yielded a return of 17%, 6.75% ₹ 100 Treasury Bills are traded at ₹ 108. Ascertain –
i. Expected return on shares of Vinani Ltd. under CAPM.
ii. Alpha Factor of shares of Vinani Ltd. if the past 5 years actual return on shares of Vinani Ltd. are – 22.50%, 26.30%, 25.70%, 23.40% and 27.60%.

[(2+2+2)+(2+6)+(3+3)]

Answer:

(a) Long Call — it will be exercised if stock price increases above strike price.

Long Put — it will be exercised if stock price decreases below strike price.

ONGC Stock price	Action by the buyer	Investor's	
		Payoff	Profit in ₹
₹ 350	Call: Not exercised Put: Not exercised	₹ 0 + ₹ 0	- ₹ 25 - ₹ 5 = - ₹ 30
₹ 500	Call: Exercised Put: Not exercised	₹ 100 + ₹ 0	- ₹ 25 + ₹ 100 - ₹ 5 = ₹ 70
₹ 250	Call: Not exercised Put: Exercised	₹ 0 + ₹ 50	- ₹ 25 - ₹ 5 + ₹ 50 = ₹ 20

(b) Exchange Traded Funds (ETFs) are just what their name implies: baskets of securities that are traded, like individual stocks, on an exchange. Unlike regular open-end mutual funds, ETFs can be bought and sold throughout the trading days, like any stock.

The concept of ETF first came into existence in the USA in 1993. It took several years to attract public interest. Most ETFs charge lower annual expenses than index mutual funds. However, as with stocks, one must pay a brokerage to buy and sell ETF units, which can be a significant drawback for those who trade frequently or invest regular sums of money.

Applications of ETF are:

1. Managing Cash Flows - Investment and fund managers, who see regular inflows and outflows, may use ETFs because of their liquidity and their capability to represent the market.

2. Diversifying Exposure - If an investor is not aware about the market mechanism and does not know which particular stock to buy but likes the overall sector, investing in shares tied to an index or basket of stocks, provides diversified exposure and reduces risk.

3. Efficient Trading - ETFs provide investors a convenient way to gain market exposure viz. an index that trades like a stock. In comparison to a stock, an investment in an ETF index product provides a diversified exposure to the market

4. Shorting or Hedging - Investors who have a negative view on a market segment or specific sector may want to establish a short position to capitalize on that view. ETFs may be sold short against long stock holdings as a hedge against a decline in the market or specific sector.

5. Filling Gaps - ETFs tied to a sector or industry may be used to gain exposure to new and important sectors. Such strategies may also be used to reduce an overweight or increase an underweight sector.

6. Equalizing Cash - Investors having idle cash in their portfolios, may want to invest in a product tied to a market benchmark. An ETF, is a temporary investment before deciding which stocks to buy or waiting for the right price.

(c)

i. Expected Return on shares of Vinani Ltd. [E(R_V)] (Under CAPM)

Computation of Risk Free Return (R_F)

Particulars	Value
Face value of Treasury Bills	₹ 100
Return on Face Value (in %)	6.75%
Return on Treasury Bills (in value) [₹ 100 x 6.75%]	₹ 6.75
Trading Price of Treasury Bills	₹ 108
Risk Face Return (R_F) as per Market Expectations [Actual Return ₹ 6.75/Market Price ₹ 108]	6.25%

Expected Return [E(R_V)]

E(R_V) $R_F + [\beta_V \times (R_M - R_F)]$
Risk free return R_F = 6.25% [As per Working Note above]
Return on Market Portfolio R_M = 17.00% [Return on NIFTY]
Beta factor β_V = 1.80 [Given]

$$\begin{aligned} E(R_V) &= R_F + [\beta_V \times (R_M - R_F)] \\ &= 6.25\% + [1.80 \times (17.00\% - 6.25\%) \\ &= 6.25\% + [1.80 \times 10.75\%] \\ &= 6.25\% + 19.35\% = 25.60\% \end{aligned}$$

ii. Value of Alpha (α_V) for Return on shares of Vinani Ltd. [E(R_V)]

Year	Actual Return	Abnormal Return [A(R_V)]
1	22.50%	22.50% - 25.60% = (3.10%)
2	26.30%	26.30% - 25.60% = 0.70%
3	25.70%	25.70% - 25.60% = 0.10%
4	23.40%	23.40% - 25.60% = (2.20%)
5	27.60%	27.60% - 25.60% = 2.00%
Total		**(2.50%)**

$$\alpha_V = \sum AR_V \div n = (2.50\%) \div 5 \text{ years} = (0.50\%)$$

Inference: Alpha is negative. Therefore, expected return will be less than return under CAPM to the extent to 0.50%.

Section II

(Corporate Laws)

Answer **Question 5** (carrying 10 marks) which is compulsory and answer **any two** (carrying 15 marks each) from the rest in this section.

Question 5.

(a) Choose the most appropriate alternative from the stated options and write it down: [6×1]

(i) The concept of Corporate Governance was initiated on the recommendation of the report by:
(A) Mr. Narayana Murthy;
(B) Mr. Kumar Mangalam Birla;
(C) Dr. Y.V. Reddy;
(D) None of the above.

(ii) Prospectus is not required to issue by/in respect of:
(A) Private limited company;
(B) Sweat equity shares;
(C) Rights issue;
(D) All of the above.

(iii) Under Competition Act, 2002, penalty for offences in relation to furnishing of information is:
(A) ₹ 5 lakhs;
(B) ₹ 25 lakhs;
(C) ₹ 10 lakhs;
(D) ₹ 50 lakhs.

(iv) In the context of classification of risk, cash/reserve management risk will fall under:
(A) Liquidity Risks;
(B) Legal Risks;
(C) System Risks;
(D) Credit Risks.

(v) The Government has allowed foreign institutional investors such as pension funds, mutual funds investment trust etc. to invest in the Indian Capital Market provided they are registered with:
(A) RBI;
(B) SEBI;
(C) Central Government;
(D) Registrar of the companies.

(vi) As per Clause----- of the Listing Agreement, a listed company is required to obtain a certificate from the auditors of the entity as regards compliance of conditions of corporate governance as stipulated in that clause. (Fill in the gap from the below)
(A) 45;
(B) 46;
(C) 49;
(D) None of the above.

(b) Fill in the blanks in the following sentences by using appropriate word(s)/phrase(s)/ number(s): [4×1]

(i) The Competition Commission shall consist of a Chairperson and not less than two and not more than _________ other Members to be appointed by the Central Government.

(ii) The minimum number of subscribers sign in the Memorandum of Association of a public limited company at the time of its formation is ___________.

(iii) The information sought for by an applicant under the RTI Act shall be furnished within ____________ days.

(iv) The _________________ has the power to fill up the casual vacancy caused in the Board.

Answer to 5(a):

(i) B. Mr. Kumar Mangalam Birla
(ii) D. All of the above
(iii) C. ₹ 10 lakhs
(iv) A. Liquidity Risks
(v) B. SEBI
(vi) C. 49

Answer to 5(b):

(i) ten
(ii) seven
(iii) thirty
(iv) Board of Directors

Question 6.

(a) Jupiter Textiles Ltd. was incorporated on 1st June, 2011. On 1st March, 2014 a political party approaches the company for a contribution of ₹ 12 lakhs for political purpose.

Your advice is sought in respect of the under mentioned issues:

(i) Is the company legally authorized under the Companies Act, 1956 to give this political contribution?
(ii) Will it make any difference, if the company was in existence on 1st January, 2011?
(iii) Can the company be penalised for violation of the applicable provisions relating to political contribution?
(iv) What are the disclosure requirements in this regards?

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

(c) A company may issue Sweat Equity Shares of a class of shares already issued if few conditions are fulfilled. State those conditions which are required to be fulfilled.

[(2+1+2+2)+4+4]

Answer:

(a) Political Donations:

(i) Only a company which had been inexistence for 3 years can make contribution to political parties. Since in the given case, the company has not completed three years of existence on 1st March, 2014, it is not eligible to give political contribution.

(ii) Yes, because in the case, Jupiter Textiles Ltd. shall complete three financial years of its existence, therefore, will be eligible to give political contribution subject to the condition that such a political contribution should not exceed 5 per cent of the Average Net profits and a resolution authorizing such contribution is passed at a meeting of the Board of Directors.

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

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

(iv) The amended Section 293A of the Companies Act, 1956 seeks to impose an obligation to disclose in its profit and loss account contributions made by it to any political party or for any political purpose. Contravention of the provisions of this section will make a company liable of fine which may extend to three times the amount so contributed. Further every officer of the company in default would be liable to imprisonment for a term which may extend to three years and also to fine.

(b) Evaluating the going concern uncertainties:

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

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

(c) A company may issue Sweat Equity Shares of a class of shares already issued if the following conditions are fulfilled:

1. The issue of these shares is authorized by a special resolution passed by the company in the general meeting.
2. The resolution shall specify the number of shares, current market price, consideration if any and the class or classes of directors or employees to whom such equity shares are to be issued.
3. Not less than one year has, at the date of the issue elapsed since the date on which the company was entitled to commence the business.
4. The sweat equity shares of a company whose equity shares are listed on a recognized stock exchange are issued in accordance with the regulations made by the Securities Exchange Board of India in this behalf. However in the case of a company whose equity shares are not listed on any recognized stock exchange, the sweat equity shares are issued in accordance with the guidelines as may be prescribed.

Question 7.

(a) The Public Information Officer of Kolkata Municipal Corporation has turned down the request for information lodged by Ms Mitrika Roy on the grounds that the request was sent through an e mail and on the ground that the same was in Bengali and not in English.

Are his contentions correct in law as per the Right to Information (RTI) Act, 2005?

(b) Akash had applied for the allotment of 1,000 shares in a company. No allotment of shares was made to him by the company. Later on, without any further application from Akash, the company transferred 1,000 partly-paid shares to him and placed his name in the Register of Members. Akash, knowing that his name was placed in the Register of Members, took no steps to get his name from the Register of Members. The company later on made final call. Akash refuses to pay for this call. Referring to the provisions of the Companies Act, 1956, examine whether his refusal to pay for the call is tenable and whether he can escape himself from the liability as a member of the company.

(c) State few objectives to change the object clause of the Memorandum of Association. Also list the procedures to be adopted for alteration of object clause in the Memorandum of Association.

[4+4+(2+5)]

Answer:

(a) Section 6(1) of the RTI Act, 2005 enjoins that a person desirous of obtaining information shall make a request in writing or through electronics means in English or in the official Language of the Area, in which the Application is being submitted, to the Public Information Officer. The Section makes two things clear:

(i) The request can be through electronic Media. E-mail is an accepted from of Electronic Communication.
(ii) The request can be in English or in the official language of the Area in which the application is being submitted.

In Kolkata, Bengali is the official language of the Area.

Therefore, the refusal on the grounds that the request was not in English and that the same was sent through e-mail, is not justified.

(b) Register of members is a prima facie evidence of any matters directed or authorized to be inserted therein by the Act (Sec. 164 of the Companies Act, 1956). A person, who knowingly permits entering his name in the register of members, becomes a member by estoppels or acquiescence. In other words, if the name of a person is entered in the register of members, although he is not a member, but such person does not object to it (i.e. he does not apply for rectification of register of members), he becomes a member by estoppels.

As per the above, Akash is a member by estoppels, since he knowingly permitted entering his name in the register of members. So he is liable to pay the final call, as a member by estoppels is liable to pay the unpaid call.

(c) The object clause of the Memorandum of Association can be changed for the following purposes of enabling the company:
- To carry on its business more economically or more efficiently.
- To attain its main purpose by new or improved means
- To enlarge or change the local area of operation
- To carry on some business which under existing circumstances may conveniently or advantageously be combined with the objects specified in the Memorandum.

The following procedure should be adopted for the alteration of object clause in the Memorandum of Association:
- A special resolution must be passed.
- A petition should be filed with the National Company Law Tribunal for confirmation of the change.
- The consent of the creditors of the company should be obtained or their claims paid off or secured.
- Notice should be given to the Registrar of companies so that he can appear before the Tribunal and state his objections and suggestions if any.
- After the Tribunal has confirmed the alteration, a certified copy of the Tribunal's order together with a printed copy of the Memorandum as altered shall be filed with the Registrar within 3 months of the date of the order.
- The certificate of the Registrar of Companies is conclusive evidence of the alteration and its validity. The alteration takes effect after it is registered. If no registration is made within 3 months, the alteration and the entire proceedings connected herewith become void.

Question 8.

(a) A, who was appointed as a Director at the last AGM (Annual General Meeting) resigned. The Board filled up the vacancy by appointing B. But within few days of his becoming Director, B died. The Board wishes to appoint C in place of B in the next board Meeting. Can the Board do so?

(b) What is Project Governance? State the benefits of Project Governance?

(c) X, a chemical manufacturing company distributed ₹ 20 lacs to scientific institutions for furtherance of scientific education and research. Referring to the provisions of the Companies Act, 1956 decide whether the said distribution of money was "Ultra vires" the company?

(d) In the case of winding up by the Tribunal, state the powers of the Liquidator, with the sanction of the Tribunal.

[3+(2+2)+2+6]

Answer:

(a) Casual vacancy u/s 262 of the Companies Act, 1956 is the vacancy arising in the office of the director appointed by the Company in the General Meeting before the expiry of his term of office.

In the above case, the vacancy on account of death of B cannot be considered as a casual vacancy in the office of the director, as the appointment of B himself was not originally made by the Company in General Meeting.

However, in the interest of the smooth working of a company, if the casual vacancy is in an office which was filled by election at a general meeting, then the Board may fill the casual vacancy as many times as necessary, i.e., if the original appointment was made by the company in the General Meeting any subsequent casual vacancy to the office of the Director can be filled by the Board [Company News & Notes 01.07.1963 issue].

Hence, in the above case, the Board can appoint C as Director.

(b) Project Governance extends the principle of Governance into both the management of individual projects via Governance structures, and the management of projects at the business level, for example via Business Reviews of Projects. Today, many organisations are developing models for 'Project Governance Structures', which can be different to a traditional Organisation Structure in that it defines accountabilities and responsibilities for strategic decision-making across the project. This can be particularly useful to project management processes such as change control and strategic (project) decision-making. When implemented well, it can have a significantly positive effect on the quality and speed of decision making on significant issues on projects.

Benefits of Project governance: Project governance will:

1) Outline the relationships between all internal and external groups involved in the project.
2) Describe the proper flow of information regarding the project to all stakeholders.
3) Ensure the appropriate review of issues encountered within each project.
4) Ensure that required approvals and direction for the project is obtained at each appropriate stage of the project.

(c) Donation of ₹ 20 lacs for furtherance of scientific education and research is permissible, as it is incidental or ancillary to the main objects of the company and it is conductive to the continued growth of the company as chemical manufacturers as was held in Evans v Brunner Mond & Company.

(d) The powers of the Liquidator, with the sanction of the Tribunal in a winding up by the Tribunal [section 457(1) of the Companies Act, 1956]:

1. To constitute or defend any suit, prosecution, or other legal proceeding, civil or criminal, in the name and on behalf of the company.
2. To carry on the business of the company so far as may be necessary for the beneficial winding up of the company.
3. To sell the immovable and movable property and actionable claims of the company by public auction or private contract, with power to transfer the whole thereof to any person or body corporate, or to sell the same in parcels.
4. To sell whole of the undertaking of the company as a going concern.
5. To raise on the security of the assets of the company any money requisite.
6. To do all such other things as may be necessary for winding up the affairs of the company and distributing of its assets.