Paper- 11: CAPITAL MARKET ANALYSIS & CORPORATE LAWS

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

The figures in the margin on the right side indicate full marks.
Please: (1) Answer all bits of a question at one place.
(2) Answers to each question should start from a new page.
Example: Q. No. 2/3/any should start from a new page.

SECTION - I (60 Marks)
(Capital Market Analysis)

Answer Question No. 1 (compulsory) and answer any two from the rest in this Section.

Question 1.

(a) In each of the cases given below one out of four options is correct. Indicate the correct answer and give workings/ reasons briefly in support of your answer. [2×6]

(i) The shares of Nalanda Ltd. are trading at ₹ 370. If put options with a strike price of ₹ 380 are priced at ₹ 20, the intrinsic value and time value of the options respectively are :
(A) ₹ 8, ₹ 8
(B) ₹ 10, ₹ 10
(C) ₹ 8, ₹ 10
(D) Incomplete 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) Determine the beta for the following portfolio :

Stock	% of portfolio	Beta
1	45	1.20
2	20	0.75
3	35	1.00

(A) 1.05;
(B) 1.04;
(C) 1.40;
(D) 1.50.

(iv) The beta of stock of Ananda Ltd. is 2.00 and is currently in equilibrium. The required return on the stock is 12% and expected return on the market is 10%. Suddenly due to change in the economic conditions, the expected return on the market increases to

12%. Other things remaining the same what would be new required return on the stock?
(A) 16.0%
(B) 15.0%
(C) 20.0%
(D) 22.5%

(v) Mr. Sanyal purchased 100 shares of NITCO Ltd. Futures @ ₹ 2,500 on 10th June. Expiry date is 26th of June. His total investment was ₹ 2,50,000 and the initial margin paid was ₹ 37,500. On 26th of June shares of NITCO Ltd. was closed at ₹ 2,000. How much will be the gain / loss on the shares?
(A) loss ₹ 50,000;
(B) gain ₹ 25,000;
(C) loss ₹ 35,000;
(D) None of the above.

(vi) Priya is willing to purchase a 5 years ₹ 1,000 par value PSU bond having a coupon rate of 9%. Her required rate of return is 10%. How much Priya should pay to purchase the bond if it matures at par? [Given PVIFA $_{(10\%,\ 5\ years)}$ = 3.791 and PVIF $_{(10\%,\ 5\ years)}$ = 0.621]
(A) ₹ 850.30;
(B) ₹ 805.47;
(C) ₹ 962.19;
(D) ₹ 965.49.

Answer:

(i) (B): ₹ 10, ₹ 10
Intrinsic Value: ₹ 380 – ₹ 370 = ₹ 10
Time Value: ₹ 20 – ₹ 10 = ₹ 10.

(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) (B): 1.04
Portfolio beta:
(0.45 x 1.20) + (0.20 x 0.75) + (0.35 x 1.00) = 1.04

(iv) (A): 16.0%
$12 = R_f + 2\ (10 - R_f)$ or, R_f = Risk free rate = 20 - 12 = 8%
Revised R (Required return) = 8 + (12 - 8) × 2 = 16%

(v) (A): ₹ 50,000
Loss to Mr. Sanyal (2,500 – 2,000) × 100 = ₹ 50,000.

(vi) (C) ₹ 962.19

Maturity of the bond at par = ₹ 1,000

Interest p.a. = ₹ 90 (₹ 1,000 × 9%), K_d = 10%

The purchase price of the bond = (₹ 90 × 3.791) + (₹ 1,000 × 0.621) = ₹ 962.19

(b) Choose the most appropriate one from the stated options and write it down (only indicate A or B or C or D as you consider correct). [1x5]

(i) Bond issued at a discount and repaid at a face value is called:

A. Zero –coupon bond;
B. Eurobond;
C. Yankee bond;
D. Income bond.

(ii) Issue of shares to its employees or directors at discount or for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value addition.

A. Seasoned Equity;
B. Green Shoe option;
C. Bought Out Deal;
D. Sweat Equity.

(iii) Markowitz Mean-Variance Model is used in:

A. Traditional Portfolio Analysis;
B. Modern Capital Market Analysis;
C. Modern Portfolio Analysis;
D. None of the above.

(iv) The Mutual Funds that are listed in the stock Exchanges are —

A. Growth schemes;
B. Closed–End Scheme;
C. Open –End Scheme;
D. None of the above.

(v) 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.

Answer:

(i) A. Zero –coupon bond
(ii) D. Sweat Equity
(iii) C. Modern Portfolio Analysis
(iv) B. Closed–End Scheme
(v) A. Bought out deal

(c) Fill in the blanks in the following sentences by using appropriate word(s) / phrase(s) / number(s): [1x3]

(i) A ________can be seen as a method for company to invest in itself by buying shares from other investors in the market.

(ii) ________________ is the practice of taking advantage of a state of imbalance between two (or more) markets and thereby making a risk free profit.

(iii) The process, by which a client in capital market can get physical certificates converted into electronic balances, is called ________________.

Answer:

(i) buy back

(ii) Arbitrage

(iii) dematerialisation

Question 2.

(a) The following two types of securities are available in the market for investment:

Security	Return (%)	Standard Deviation (%)
Gilt-edge Security	8	0
Equity	25	30

Using the above two securities, if you are planning to invest ₹ 1,00,000 to construct a Portfolio with a standard deviation of 24%, then what will be the return of such portfolio (in ₹)? [4]

Answer:

Desired standard deviation of Portfolio = 24%

Let Weight of Risk free Gilt edged securities be W_A

Hence Weight of Equity Securities is $(1 – W_A)$

$24\% = (0 \times W_A) + 30\% (1-W_A)$

$24\% = 30\% - 30\%W_A$

$$W_A = \frac{6\%}{30\%} = 0.2$$

Hence, Weight of Risk Free Assets = 0.2

Weight of Equity Securities = 0.8

ER(P) = (0.2 x 8%) + (0.8 x 25%) = 21.6%

Return in Rupees = ₹ 1,00,000 x 21.6% = ₹ 21,600.

(b) "There are differences in approach, attitude and areas of operations between commercial banks and merchant banks." — State those differences between commercial banks and merchant banks. [3]

Answer:

The differences 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.

(c) Calculation the value of option from the following information:

Current Asset Price	**(S)**	**= ₹ 30**
Exercise price	**(X)**	**= ₹ 30**
Time to expiry in decimals of a year	**(T-t)**	**= 3 months or 0.25 years**
Risk-free rate of interest in decimals	**(r)**	**= 12% = 0.12**

Annualised standard deviation of the natural log of the asset price relative to decimals(σ)=0.40

Given N (0.25) = 0.5987, N(0.05) = 0.5199 and $e^{-0.03}$ = 0.9704. **[6]**

Answer:

Since d_1 and d_2 are required inputs for Black – scholes option Pricing Model.

We know that —

$$d_1 = \frac{\ln(S/X) + (r + \sigma^2/2)(T-t)}{\sigma\sqrt{T-t}}$$

$$d_1 = \frac{\ln(30/30) + [0.12 + (0.16/2)](0.25)}{0.40(0.50)} = \frac{0 + 0.05}{0.20} = 0.25$$

Again, $d_2 = d_1 - \sigma\sqrt{T-t}$

$d_2 = 0.25 - 0.20 = 0.05$

$N(d_1) = N(0.25)$

$N(d_2) = N(0.05)$

There above two represent area under a standard normal distribution function.

From given data, we see that value of N(0.25) = 0.5987 and N(0.05)= 0.5199. We can use those values to solve the equation in Black- scholes option Pricing Model. The value of option (C) will be:

$$C = S\,N(d_1) - Xe^{-r(T-t)}N(d_2)$$

C = ₹ 30 [N (d_1)] - ₹ 30 $e^{(-0.12)(0.25)}$ [N(d_2)]

= ₹ 30 [N (0.25)] – ₹ 30(0.9704) [N(0.05)]

= ₹ 30 (0.5987) – ₹ 29.11 (0.5199)

= ₹ 17.96 – ₹ 15.13
= ₹ 2.83.

(d) State the various risks associated with derivatives? [5]

Answer:
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.

(e) What is Credit Wrapping? [2]

Answer:
Credit wrapping is a technique by which bonds are issued by a company with a poor rating can be shored up with the assistance of an institution with a strong credit rating. It involves the institution agreeing to underwrite a proportion of the amount payable in the event of default at the time of redemption. In many cases it is the only way in which poorly rated companies can issue bonds.

Question 3.
(a) Determine the intrinsic value for the buyer of an option contract, in the following situations:

(i) A put Option, when the current value of the underlying asset is ₹ 1,400 and the strike price is ₹ 1,480.
(ii) A Call Option when the strike price is ₹ 1,700 and the current value of underlying asset is ₹ 1,650.
(iii) A Call Option when the current value of the underlying asset is ₹ 950 and the strike price is ₹ 950.
(iv) A Put Option when the current value of the underlying asset is ₹ 950 and the strike price is ₹ 950.
(v) A Put Option when the exercise price is ₹ 1,090 and the current value of the underlying asset is 1,000.
(vi) A Call Option when the current value of asset is ₹ 120 and the strike price is ₹ 98.
(vii) A Call Option when the exercise price is ₹ 80 and the market price is ₹ 84.
(viii) A Put Option when the exercise price is ₹ 87 and the market price is ₹ 82. [8]

Answer:
Calculation of Intrinsic value for the buyer of an option contract:

Nature of Option	Exercise Price (₹)	Current Market Price (₹)	Cash Flows (₹)	Intrinsic Value (₹)
Put	1,480	1,400	In-the-money	80
Call	1,700	1,650	Out-of-the-money	0
Call	950	950	At-the-money	0
Put	950	950	At-the-money	0
Put	1,090	1,000	In-the-money	90
Call	98	120	In-the-money	22
Call	80	84	In-the-money	4
Put	87	82	In-the-money	5

(b) A group of analysts believes that the returns of the portfolios are governed by two vital factors—
1. The rate of economic growth and 2. The sensitivity of stock to the developments in the financial markets. The sensitivities of returns with respect to these two factors are denoted by β_1 and beta β_2 respectively.

Further these analysts believe that returns on three carefully crafted Portfolios A, B and C must be predominantly governed by these two factors alone leaving remaining to some company/ portfolio specific factors. Assume that these three Portfolios A, B, and C are found to have following beta co-efficients:

Portfolio	Expected Return, %	β_1	B_2
A	**16.00**	**1.00**	**0.80**
B	**25.00**	**1.50**	**1.30**
C	**32.00**	**2.00**	**1.50**

Find out the Arbitrage Pricing Theory (APT) equation governing the returns on the portfolios.
[7]

Answer:
Arbitrage Pricing Theory for two factors is
$R_p = \lambda_0 + \lambda_1\beta_1 + \lambda_2\beta_2$
Putting the given values in the APT to solve for three unknown variables:
For Portfolio A: $16 = \lambda_0 + \lambda_1 \times 1.00 + \lambda_2 \times 0.80$ (1)
For Portfolio B: $25 = \lambda_0 + \lambda_1 \times 1.50 + \lambda_2 \times 1.30$ (2)
For Portfolio C: $32 = \lambda_0 + \lambda_1 \times 2.00 + \lambda_2 \times 1.50$ (3)
Subtracting (1) from (2)
$9 = \lambda_1 \times 0.50 + \lambda_2 \times 0.50$ (4)
Subtracting (1) from (3)
$16 = \lambda_1 \times 1.00 + \lambda_2 \times 0.70$ (5)
Multiplying (4) with 2, we get
$18 = \lambda_1 \times 1.00 - \lambda_2 \times 1.00$ (6)
Subtracting (5) from (6), we get
$\lambda_2 = 20/3$
Putting the value in (4)

$9 = 10/3 + \lambda_1 \times 0.50$
gives $\lambda_1 = 34/3$
Putting the values of λ_1 and λ_2 in (3) we get
$32 = \lambda_0 + 2 \times 34/3 + 1.50 \times 20/3$
and $\lambda_0 = -2/3$
APT would then be $R_p = -2/3 + 34/3 \times \beta_1 + 20/3 \times \beta_2$

(c) What is Venture Capital? Describe some of its characteristics in relation to the financing.
[2+3]

Answer:

Venture capital is long term risk capital to finance high technology project which involves risk but at the same time has strong potential for growth. Venture capital refers to the commitment of capital as shareholding, for the formulation and setting up of small firms specializing in new ideas or new technologies. It is not merely an injection of funds into a new firm; it is a simultaneous input of skill needed to set up the firm, design its marketing strategy and organize and manage it.

Characteristics of venture capital:

1. Venture capital is usually in the form of an equity participation. It may also take the form of convertible debt or long term loan.
2. Investment is made only in high risk but high growth potential projects.
3. Venture capital is available only for commercialization of new ideas or new technologies and not for enterprises which are engaged in trading, booking, financial services, agency, liaison work or research and development.
4. Venture capitalist joins the entrepreneurs as a co-promoter in project and shares the risks and rewards of the enterprise.
5. Investment is usually made in small and medium scale enterprises.
6. Once the venture has reached the full potential the venture capitalist disinvests his holdings either to the promoters or in the market. The basic objective of investment is not profit but capital appreciation at the time of disinvestment.

Question 4.

(a) Bonds of Mouship Tech Ltd., an Engineering Company which carries AA rating with 5 years to maturity and 14.50% coupon rate, payable annually, is being traded at ₹ 1015.50.

You as a Fund Manager of the Trust Fund, a 80% Debt fund, want to ascertain the intrinsic Value and take a decision accordingly. Face Value of the bond is ₹ 1000. Your Asset Management Company has laid down the guideline that for AA rated Instruments; the discount rate to be applied is 364 day T-Bill rate+4%. (Assume the 364 day T-Bill rate to be 10%). You are required to:

(i) Calculate the Intrinsic value of the Bond
(ii) Calculate the current yield (CY) and the yield to Maturity of the bond (YTM).

Note: Ignore Flotation Costs and transaction costs,

Extracted from the table of PV:

Interest rate	**10%**	**11%**	**12%**	**13%**	**14%**	**15%**
PVIFA (5 years)	**3.791**	**3.696**	**3.605**	**3.517**	**3.433**	**3.352**
PVIF (5 years)	**0.621**	**0.593**	**0.567**	**0.543**	**0.519**	**0.497**

[2+(1+2)]

Answer:

(i) Calculation of Intrinsic Value of the Bond

Appropriate discount rate for valuing the Bond is: R= 10+4 = 14%

Cash Flows:

Years		P.V. Factor @ 14%	Present Value (₹)
1-5	Dividend ₹ 145 annually for 5 years	3.433	497.79
5	Maturity Value : ₹ 1,000	0.519	519.00
Intrinsic Value per bond (P_0)			1,016.79

Since the Current Market Value is less than the intrinsic value of Bond, the Bond is under priced. The Bond should be bought.

(ii) Calculation of current yield (YC):

(145 ÷ 1015.50) × 100 = 14.28%

Calculation of YTM

Since when discounted at 14%, the value is ₹ 1,016.79 (more than ₹ 1,015.50)

We try at 15% discount.

P_0 = 145 × PVIFA (15%, 5years) +1000 × PVIF (15%, 5years)

=145 × 3.352 + 1000 × 0.497 = 486.04 + 497= ₹ 983.04

As we found (i) P_0 = ₹ 1016.79

$$YTM = 14 + (15-14)\times\frac{1016.79 - 1015.50}{1016.79 - 983.04}$$

Yield to Maturity (YTM) = 14.04%

(b) A new equity based mutual fund collected ₹ 50 crores through the New Fund Offer at ₹ 10 a unit. On the first day when the NAV was to be released, the following stock purchases were made. The balance was parked in reverse repo for a day at 6% yield. The initial expense is 6% and is expected to be amortized over 5 years. The total recurring expenses which would be deducted on a daily basis (which also includes investment and advisory fees for this fund size) is 2.5% per annum. Assume recurring expenses is charged on opening balance of net assets. Find 1st day NAV for this fund.

Name of the stock	**Qty.**	**Cost (₹)**	**Closing price (₹)**
BHEL	**2,500**	**1,968.00**	**1,968.25**
Infosys	**3,000**	**1,600.00**	**1,630.20**
TCS	**2,500**	**928.00**	**928.00**
ITC	**25,600**	**169.00**	**164.55**
Reliance Communication	**16,500**	**265.00**	**258.20**

[5]

Answer:

Fund collection : ₹ 50.00000 crores
Stock purchases : ₹ 2.07389 crores
Balance corpus : ₹ 47.92611 crores
Income – repo (₹ 47,92,61,100 x 0.06) x (1/365) = ₹ 78,783
Unrealized loss : - ₹ 1,34,895
Initial expenses (0.06 × ₹ 50 crores) ÷ (5 x 365)= ₹ 16,438 [amortised over five years]
Recurring expenses (0.025 × ₹ 50 crores) ÷ 365 = ₹ 34,247

Name of the stock	Qty	Cost (₹)	Closing price (₹)	Total cost (₹)	Unrealized gain/loss (₹)
BHEL	2,500	1,968	1,968.25	49,20,000	625
Infosys	3,000	1,600	1,630.20	48,00,000	90,600
TCS	2,500	928	928.00	23,20,000	0
ITC	25,600	169	164.55	43,26,400	-1,13,920
Reliance Communication	16,500	265	258.20	43,72,500	-1,12,200
				2,07,38,900	**-1,34,895**

First day's NAV of equity based fund

$$= \frac{\text{Balance Corpus} + \text{Income} + \text{Stock Purchases} - \text{Unrealised Loss} - \text{Expenses}}{\text{Outstanding Number of Units}}$$

$$= \frac{₹\ 47.92611 \text{ crores} + ₹\ 78,783 + ₹\ 2.07389 \text{ crores} - ₹\ 1,34,895 - ₹\ 16,438 - ₹\ 34,247}{₹\ 5 \text{ crores}}$$

$$= \frac{₹\ (47.92611 + 0.00788 + 2.07389 - 0.01349 - 0.00164 - 0.00342) \text{ crores}}{₹\ 5 \text{ crores}}$$

= ₹ 9.99855

(c) "Bought out deal is not only advantageous to the company going for it but also to the sponsors and common investors." — State the advantages of Bought out deal (BOD). [5]

Answer:

Bought out deal is not only advantageous to the company going for it but also to the sponsors and common investors. The advantages of Bought out deal (BOD) are as follows —

1. The company has the advantage of using the fund immediately without waiting as in the case of direct public issue. In case of BOD the company instantly gets funds and is able to

focus its attention on project implementation without worrying for source of investment. Bought out deals are ideally suited in circumstances when money needs to be arranged fast without which the project may suffer. Lowering or eliminating issue cost from the preliminary expenses is another advantage to the company.

2. The time taken to raise money in the capital market by a company takes as much as six months and this time is very high for a company in an infancy stage. The waste of time in the initial stage can be avoided by going for BOD.
3. In case of a new and untried product it is easier to convince an investment banker for an investment in the company rather than the general public. Hence BOD is an innovative method of financing for such companies.
4. When the market sentiment is low and the secondary market is undergoing a bear phase, a company may not like to come to the market with a public issue. In such case BOD is a superior process to get fund for the company.
5. The merchant bankers also gain handsomely from a BOD. The merchant banks expect a return of around 30% from a BOD whereas private financing institutions expect a return of 40% to 60% from a BOD. The gains can be tremendous provided the sponsors select proper issues and price it attractively to the investors.
6. The investors also gain from the BOD in a way that they get good issues where some merchant banker has already invested in it. The common investors do not have enough scope and information for proper evaluation of a company. The merchant bankers are professionals and can make proper appraisal of a company.

(d) "Many corporate executives are faced with the challenge of managing the risks associated with low cost basis and restricted-stock holdings." — Describe the risk management strategies each of which has an unique characteristics and requirements. [5]

Answer:

Risk Management Strategies:

(i) Risk Avoidance is just that, avoiding the risk associated with a specific task, activity or project. Risk avoidance is strictly a business decision, and sometimes a very good strategy if construction documents are unclear, ambiguous or incomplete.

(ii) Risk Abatement is the process of combining loss prevention or loss control to minimize a risk. This risk management strategy serves to reduce the loss potential and decrease the frequency or severity of the loss. Risk abatement is preferably used in conjunction with other risk management strategies, since using this risk management method alone will not totally eliminate the risk.

(iii) Risk Retention is a good strategy only when it is impossible to transfer the risk. Or, based on an evaluation of the economic loss exposure, it is determined that the diminutive value placed on the risk can be safely absorbed.

(iv) Risk Transfer is the shifting of the risk burden from one party to another. This can be done several ways, but is usually done through conventional insurance as a risk transfer mechanism, and through the use of contract indemnification provisions.

(v) Risk Allocation is the sharing of the risk burden with other parties. This is usually based on a business decision when a client realizes that the cost of doing a project is too large and needs to spread the economic risk with another firm. Also, when a client lacks a specific competency that is a requirement of the contract, e.g., design capability for a design-build project. A typical example of using a risk allocation strategy is in the formation of a joint venture.

SECTION II (40 Marks)

(Corporate Laws)

Answer Question No.5 (compulsory) and also answer any two from the rest in this Section.

Question 5.

(a) Fill in the Blanks in the following sentences by using appropriate word(s)/ phrase(s)/ number(s): [1x6]

(i) The Competition Commission of India was established in the month of _________, 2003 under the Competition Act, 2002.

(ii) The _____________ has the power to fill up the casual vacancy caused in the Board.

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

(iv) As per section ____ of the Companies Act, 2013 where a prospectus, issued, circulated or distributed which is untrue or misleading every person who authorizes the issue of such prospectus shall be liable (criminal liability).

(v) As per Section 205(1A) of the Companies Act, 1956 the amount of interim dividend shall have to be deposited from the date of declaration of such dividend in a separate bank account within ________ days.

(vi) A _____________ is a person who undertakes, does and goes through all the necessary and other preliminary activities with an objective of bringing the company into existence.

Answer:

(i) October
(ii) Board of Directors
(iii) seven
(iv) 34
(v) five
(vi) promoter

(b) Choose the most appropriate one from the stated options and write it down (only indicate A, B, C or D as you consider correct): [1×4]

(i) For a company, other than non profit making, minimum how many days notice should be given for calling a general meeting:

A. 17 days;
B. 19 days;
C. 21 days;
D. 14 days.

(ii) Which of the following items requires special resolution in a general meeting under the Companies Act, 1956?

A. Issue of shares at discount;

B. Adoption of Statutory Report;
C. Appointment of Managing/ Whole-time Director;
D. Reduction of Share Capital.

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

(iv) In the context of Corporate Governance, Narayana Murthy Committee was formed in the year:
A. 2002;
B. 2003;
C. 2004;
D. 1999.

Answer:

(i) C. 21 days
(ii) D. Reduction of Share Capital
(iii) B. Kumar Mangalam Birla
(iv) B. 2003

Question 6.

(a) What are the procedures to be adopted for the alteration of object clause in the Memorandum? [6]

Answer:

The following procedure should be adopted for the alteration of object clause in the Memorandum —

1. A special resolution must be passed.
2. A petition should be filed with the National Company Law Tribunal for confirmation of the change.
3. The consent of the creditors of the company should be obtained or their claims paid off or secured.
4. 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.
5. 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.

6. 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.

(b) In the context of management audit, what is meant by "control risk" vis-a-vis detection of material misstatements in the financial statements? In this regard, what is "Control Risk at the maximum" and "Control Risk at less than the maximum"? [1+(2+2)]

Answer:

Control Risk: The risk that the client's internal control policy and procedures are not effective in preventing or detecting material misstatements in the financial statements.

1. Control risk at the maximum

Conclusion based upon the auditor's judgement that the client's internal control policies and procedures do not reduce to a low level the potential that the financial statements are free of material errors and / or irregularities. After reaching this assessment the auditor would only be required to document in his/her work papers the fact that control risk is at the maximum and not the basis for reaching this conclusion. The auditor may decide control risk is at the maximum based upon management accounting technique called cost benefit decisions.

2. Control risk at less than the maximum

Based upon his / her initial understanding of the internal control components, the auditor may conclude that control risk may be less than the maximum. The auditors in this situation must evaluate the cost/benefit of existing his/her understanding of internal controls to make a final decision concerning control risk. The cost / benefit decision is based upon the audit time involved in extending the auditor's understanding of internal controls, including tests of control versus the time that may be saved with the possible reduction of substantive audit tests.

(c) Mr. Roy was appointed as Managing Director for life by the Articles of Association of a private company incorporated on 1st June, 1990. The articles also empowered Mr. Roy to appoint a successor. Mr. Roy appointed, by will, Mr. Sen to succeed him after his death. Can Mr. Sen succeed Mr. Roy as Managing Director after the death of Mr. Roy? [4]

Answer:

No director shall assign his office to any other person. If he does, the assignment shall be void (Section 312 of the Companies Act, 1956).

The Articles of a company empowered its Managing Director to appoint a successor. The Managing Director appointed, by his will, Mr. Sen to succeed him as a managing director after his death. The Court observed that a director is prohibited from assigning his office. The word 'his' used in section 312 indicates that the prohibition applies only when an office held by a director is assigned to any other person. Where a director dies, the office held by him becomes vacant and therefore such office cannot be assigned to any other person. Therefore, appointment of a new person in such office does not amount to an assignment within the meaning of section 312. [Oriental Metal Pressing Pvt. Ltd. v B.K. Thakoor (1961) 31 Comp Cas 143].

The facts of the given case are identical to the facts discussed in the above case. Accordingly, it can be said that appointment of Mr. Sen is valid and it does not amount to an assignment of office by Mr. Roy.

Question 7.

(a) Mr. H. Jalan, attained the age 59 years on 31st December, 2013. The Central Government appointed him as the Chairperson of the Competition Commission of India with effect from 1st January, 2014.

You are required to state with reference to the provisions of the Competition Act, 2002, the term for which he may be appointed as Chairperson of the Competition Commission of India. Whether he can be reappointed as such and till when he can remain as Chairperson of the Competition Commission of India? [4]

Answer:

According to Section 10(1) of the Competition Act, 2002, the Chairperson and every other Member shall hold office as such for a term of five years from the date on which he enters upon his office and shall be eligible for reappointment.

Provided that the Chairperson or other Members shall not hold office as such after he has attained the age of sixty-five years.

Based on the above provisions of the Competition Act, 2002, it can be concluded that Mr. H. Jalan can be appointed as the Chairperson of the Competition Commission of India by the Central government initially for a period of five years and he can also be reappointed after his initial term of five years is over. But since he shall be attaining the age of 65 years as on 31st December, 2019, he will have to step down from the post on his attaining the age of 65 years.

(b) "A good Corporate Governance should have certain basic principles" — Enumerate them. [7]

Answer:

Principles of corporate governance:

A good governance should include the following principles:

(i) Review of operation – There should be review of operations of the company at a regular interval. It may include comparison of monthly/quarterly production and sales targets with actual, cash flow analysis, etc.

(ii) Compliance with Statutory and Regulatory requirements – the Board should ensure compliance with various statutory and regulatory requirements. It may include clearance of statutory dues, compliance with FERA regulations, following suitable accounting policies and standard, etc.

(iii) Appointment of various committees – There should be appointment of various committees to look after different matters. There can be following committees – (1) Audit Committee, (2) Grievance Committees, (3) Remuneration Committee and (4) Investment Committee etc.

1. Audit Committee – It should meet periodically to review the effectiveness of the system of internal controls and reports to shareholders.
2. Grievance Committee – It should look after the grievances from customers, suppliers, creditors in respect of price, quality, discount, etc. It should also look after the problems of executives/employees of the organization.
3. Remuneration committee – Its role should be to fix remuneration of non-executive directors. It may be fixed in relation to company performance.
4. Investment committee – It should look after the investment decisions. It should be in accordance with the guidelines approved by the Board. Shareholders expect that investment decisions are judicious and do not incur any losses, which affect shareholder's interest.

(iv) Contribution of employees' Union – Employees' or workers' union should also contribute significantly to good corporate behaviour by promoting work culture. In this case, inclusion of employees or worker's representative on the board may be thought of.

(v) Contribution to community Development – A good corporate governance should help community development programme by active participation. It should adopt measures for pollution control, and follow fair and ethical business practices.

Good corporate governance calls for accountability for all Concerned. The Shareholders, Directors, auditors, executives, advisers and other staff who are associated with the working of the corporate should combined their efforts to improve the system and ensure good management practices.

(c) What are the duties to be performed by the auditors in the course of audit? [4]

Answer:

The following are the duties of auditors:

1) The auditor of a company should acquaint himself with the articles of association and memorandum of association of the company as well as with the Companies Act.
2) The auditor has to perform his work in a professional manner and he should exercise reasonable care and skill in the performance of his duties. He need not be suspicious all the time but whenever he feels that a particular matter is suspicious, he should probe the same thoroughly. It is said that, 'an auditor should be watch dog and not a blood hound'.
3) An important duty of an auditor is to make a report on the accounts of the company and submit the same to the members in an annual general meeting. It should be noted that the auditor is appointed by the members in the annual general meeting and he is accountable to them. He has to state in his report, whether the accounts of the company show a true and fair view of the affairs of the company.
4) In addition to the above mentioned duties, the auditor has the other duties like preparation of statutory report, certifying specified things in the prospectus and providing assistance in investigation.

Question 8.

Write a short note on: [5×3]

(a) Director Identification Number (DIN)

(b) The Objectives of the Right to Information Act, 2005

(c) Shelf prospectus [Section 31 of the Companies Act, 2013]

Answer:

(a) Director Identification Number (DIN): According to section 266A of the Companies Act, 1956, every individual, intending to be appointed as director of a company or director of a company appointed before the commencement of the Companies [Amendment] Act, 2006, shall make an application for allotment of Director Identification Number to the Central Government in such form and manner [including electronic form] along with such fees as may be prescribed. Such an application shall be made within 60 days of the commencement of this Act.

Section 266B of the Companies Act, 1956 provides that the Central Government shall, within one month from the receipt of the application, allot a Director Identification Number to an applicant, in such manner as may be prescribed. The Identification Number shall be only one and no director shall apply, obtain or possess another identification number. The identification number shall be informed to the company or all companies wherein he is a director within one month of the receipt of the number. The number shall also be informed to the Registrar within one week of the receipt of the number. Every person or company, while furnishing any return, information or particulars as are required to be furnished under this Act, shall quote the Director Identification Number in such returns, information or particulars in case such return, information or particulars relate to the director or contain any reference to the director.

(b) The Objectives of the Right to Information Act, 2004:

(i) give effect to the Fundamental Right to Information, which will contribute to strengthening democracy, improving governance, increasing public participation, promoting transparency and accountability and reducing corruption

(ii) establish voluntary and mandatory mechanisms or procedures to give effect to right to information in a manner which enables persons to obtain access to records of public authorities in a swift, effective, inexpensive and reasonable manner.

(iii) promote transparency, accountability and effective governance of all public authorities by, including but not limited to, empowering and educating all persons to:
   - understand their rights in terms of this Act in order to exercise their rights in relation to public authorities;
   - understand the functions and operation of public authorities; and effectively participating in decision making by public authorities that affects their rights.

(c) Shelf prospectus — As per section 31 of the Companies Act, 2013 "shelf prospectus" means a prospectus in respect of which the securities or class of securities included therein are issued for subscription in one or more issues over a certain period without the issue of a further prospectus.

(1) Any class or classes of companies, as the Securities and Exchange Board may provide by regulations in this behalf, may file a shelf prospectus with the Registrar at the stage of the

first offer of securities included therein which shall indicate a period not exceeding one year as the period of validity of such prospectus which shall commence from the date of opening of the first offer of securities under that prospectus, and in respect of a second or subsequent offer of such securities issued during the period of validity of that prospectus, no further prospectus is required.

(2) A company filing a shelf prospectus shall be required to file an information memorandum containing all material facts relating to new charges created, changes in the financial position of the company as have occurred between the first offer of securities or the previous offer of securities and the succeeding offer of securities and such other changes as may be prescribed, with the Registrar within the prescribed time, prior to the issue of a second or subsequent offer of securities under the shelf prospectus:

Provided that where a company or any other person has received applications for the allotment of securities along with advance payments of subscription before the making of any such change, the company or other person shall intimate the changes to such applicants and if they express a desire to withdraw their application, the company or other person shall refund all the monies received as subscription within fifteen days thereof.

(3) Where an information memorandum is filed, every time an offer of securities is made under sub-section (2), such memorandum together with the shelf prospectus shall be deemed to be a prospectus.