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)

(i) Mr. jain has the following portfolio of four shares:

Name	Beta	Investment ₹ lakh
AB Ltd.	0.25	0.60
CD Ltd.	0.35	1.50
PQ Ltd.	1.15	2.25
LM Ltd.	1.85	4.50

The risk free rate of return is 7% and the market rate of return is 14%. What will be the Portfolio Beta.

A. 0.3093
B. 1.3093
C. 1.25
D. 1.5139

(ii) 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%

(iii) The buy and sell value of two securities in stock exchange are as under:

Security	Buy Value (₹)	Sell Value (₹)
L	5,00,000	2,00,000
M	3,00,000	7,00,000

The Gross Exposure Margin is

A. ₹ 17,00,000
B. ₹ 1,00,000
C. ₹ 12,00,000
D. ₹ 7,00,000

(iv) **The following portfolio details of a mutual fund are available:**

Stock	Shares	Price (₹)
A	2,00,000	35
B	3,00,000	40
C	4,00,000	20
D	6,00,000	25

The fund has accrued management fees with the portfolio manager totaling ₹40,000. There are 40 lakhs units outstanding. What is the NAV of the fund?

A. 10.25
B. 10.39
C. 10.49
D. None of the above

(v) **The share price of Vaibhavi Ltd. (F. V. ₹ 10) quotes ₹ 500 in the NSE and the 3 months future price quotes at ₹ 525. The borrowing rate is 12% p.a. If the expected annual dividend yield is 15% payable before expiry, then the price of 3 months Vaibhavi Ltd's future would be:**

A. ₹ 500.00
B. ₹ 513.50
C. ₹ 516.50
D. Insufficient information.

(vi) **A convertible bond with a face value of ₹ 1,000 has been issued at ₹ 1,350 with a coupon rate of 1.5%. The conversion rate is 14 shares per bond. The current market price of the bond is ₹ 1,475 and that of stock is ₹ 80. The premium over conversion value is —**

A. 24.06%
B. 33.33%
C. 31.70%
D. 37.25%

(vii) **An investor purchased an asset at a cost of ₹ 1,300. Simultaneously he purchases a put option to sell the said asset at a minimum price of ₹ 1,300 at a premium of ₹ 70. Premium is payable immediately and expiration is 2 months. What is the cost of strategy and Break-even Point?**

A. ₹ 70 and ₹ 1,370
B. ₹ 70 and ₹ 1,230
C. ₹ 1,370 and ₹ 1,230
D. None of the above

[7 × 2]

(b) Choose the most appropriate one from the stated options and write it down:

(i) **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

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

A. Initial Public Offer
B. Rights issue

C. Buy back
D. Book Building

(iii) Interest rate sensitivity for bonds with embedded options is most accurately measured by:
A. Convexity
B. Effective duration
C. Modified duration
D. Macaulay duration

(iv) 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

(v) The Security Market Line shows the linear relationship between the expected returns and —
A. alpha of the portfolio
B. Betas of the securities
C. variance of the portfolio
D. none of the above

(vi) Which of the following is not a group of Mutual fund:
A. Income Oriented funds
B. Tax Relief Funds
C. Bond Funds
D. Area Funds

Answer to Question 1(a):

(i) B. 1.3093

Computation of Portfolio Beta using weighted average method:

$$Beta_P = \left(0.25 \times \frac{0.60}{8.85}\right) + \left(0.35 \times \frac{1.50}{8.85}\right) + \left(1.15 \times \frac{2.25}{8.85}\right) + \left(1.85 \times \frac{4.50}{8.85}\right)$$

$= (0.25 \times 0.0678) + (0.35 \times 0.1695) + (1.15 \times 0.2542) + (1.85 \times 0.5085)$
$= 0.01695 + 0.059325 + 0.29233 + 0.940725$
$= 1.3093$

(ii) 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%

(iii) D. ₹ 7,00,000

Security	Buy Value (₹)	Sell Value (₹)	Buy Value-Sell Value (₹)
L	5,00,000	2,00,000	3,00,000
M	3,00,000	7,00,000	- 4,00,000

The Gross Exposure Margin: S (I 300000 I + I -400000 I)
= ₹ 7,00,000

(iv) C. ₹ 10.49
The following portfolio details of a fund are available:

Stock	Shares	Price	Value (₹)
A	2,00,000	35	70,00,000
B	3,00,000	40	1,20,00,000
C	4,00,000	20	80,00,000
D	6,00,000	25	1,50,00,000
Total			4,20,00,000

NAV of the fund = (₹4,20,00,000 - ₹ 40,000)/40,00,000 = ₹ 10.49

(v) B. ₹ 513.50
Future Price = Spot price + Cost of Carry – Dividend
= ₹ [500 + (500 × 0.12 × 3/12) – 10 × 0.15]
= ₹ (500 + 15 – 1.50) = ₹ 513.50

(vi) C. 31.70%
Conversion rate is 14 shares per bond
Market price per share is ₹ 80
Conversion value = ₹ (80 × 14) = ₹ 1,120
Market price of the bond = ₹ 1,475
Therefore, premium over conversion value = 335/1,120×100
= 31.70%

(vii) A. ₹ 70 and ₹ 1,370
Cost of strategy = Premium = ₹ 70
Break-even Point = ₹ 1,300 + ₹ 70 = ₹ 1,370

Answer to Question 1(b):

(i) B. Closed–End Scheme
(ii) C. Buy back
(iii) B. Effective duration
(iv) D. Sweat Equity
(v) B. Betas of the securities
(vi) C. Bond Funds

Question 2.

(a) The possible returns and associated probabilities of Securities X and Y are given below:

Security X		Security Y	
Probability	**Return %**	**Probability**	**Return %**
0.05	**6**	**0.10**	**5**
0.15	**10**	**0.20**	**8**
0.40	**15**	**0.30**	**12**
0.25	**18**	**0.25**	**15**
0.05	**22**	**0.10**	**18**
0.10	**20**	**0.05**	**20**

Calculate the expected return and standard deviation of Security X and Y.

(b) How many levels of Market Efficiency can be identified? State in details.
(c) What is Credit Wrapping?
(d) Write down the benefits of CAPM model in the field of portfolio management.

[10+5+2+3]

Answer:
(a) Calculation of expected Return and Standard Deviation of Security X

Probability (P)	**Return % (R)**	**(P×R)**	$(R-\overline{R})$	$(R-\overline{R})^2P$
0.05	6	0.30	-9.4	4.418
0.15	10	1.50	-5.4	4.374
0.40	15	6.00	-0.4	0.064
0.25	18	4.50	2.6	1.69
0.05	22	1.10	6.6	2.178
0.10	20	2.00	4.6	2.116
		$\overline{R}$ = 15.40		$\sum(R-\overline{R})^2P = 14.84$

Expected return of Security X = 15.40%
Standard of Deviation of Security X

$$\sigma_X^{\ 2} = 14.84$$

$$\sigma_X = \sqrt{14.84} = 3.85$$

Calculation of expected Return and Standard Deviation of Security Y

Probability (P)	**Return % (R)**	**(P×R)**	$(R-\overline{R})$	$(R-\overline{R})^2P$
0.10	**5**	0.50	-7.25	5.2563
0.20	**8**	1.60	-4.25	3.6125
0.30	**12**	3.60	-0.25	0.0188
0.25	**15**	3.75	2.75	1.8906
0.10	**18**	1.80	5.75	3.3063
0.05	**20**	1.00	7.75	3.0031
		$\overline{R}$ = 12.25		$\sum(R-\overline{R})^2P = 17.0876$

Expected return of Security Y = 12.25%
Standard Deviation of Security Y

$$\sigma_Y^{\ 2} = 17.0876$$

$$\sigma_Y = \sqrt{17.0876} = 4.13$$

Analysis- Security X has higher expected return and lower level of risk as compared to Security Y.

(b) Economists have defined different levels of efficiency according to the type of information, which is reflected in prices. Three levels of market efficiency can be identified.

(i) Weak-form efficiency – share prices fully reflect all information contained in past price movements. It is pointless basing trading rules on share price history, as the future cannot be predicted in this way.

(ii) Semi-strong form efficiency – share prices fully reflect all the relevant publicly available information. This includes not only past price movements but also earnings and dividend announcements, rights issues, technological breakthroughs, resignations of directors, and so on. The semi-strong form of efficiency implies that there is no advantage in analyzing publicly available information after it has been released, because the market has already absorbed it into the price.

(iii) Strong-form of efficiency – all relevant information, including that which is privately held, is reflected in the share price. Here the focus is on insider trading, in which a few privileged individuals (for example directors) are able to trade in shares, as they know more than the normal investor in the market. In a strong-form efficient market even insiders are unable to make abnormal profits.

(c) 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.

(d) CAPM model of portfolio management can be effectively used to:
1. Investments in risky projects having real assets can be evaluated of its worth in view of expected return.
2. CAPM analyses the riskiness of increasing the levels of gearing and its impact on equity shareholders returns.
3. CAPM suggests the diversification of portfolio in minimisation of risk.

Question 3.
(a) What are the differences between Futures and Options?
(b) 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 ₹)?

(c) What is Money Market? Write about the importance of Money Market.
(d) "Despite the assertions of technical analysis, technical analysis is not a sure-fire method." — Describe the criticisms of Technical Analysis in this ground.

[4+5+7+4]

Answer:
(a) Both futures and options are useful derivatives but have some fundamental differences between the two types of derivatives. They are:

Futures	Options
1. Both the parties are obliged to perform the contract.	1. Only the seller (writer) is obligated to perform the contract.

2. No premium is paid by either parties.	2. The buyer pays the seller (writer) a premium.
3. The holder of the contract is exposed to the entire spectrum of downside risk and has potential for all the upside return.	3. The buyer's loss is restricted to downside risk to the premium paid, but retains upward indefinite potentials.
4. The parties of the contract must perform at the settlement date. They are not obligated to perform before the date.	4. The buyer can exercise option any time prior to the expiry date.

(b) 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.

(c) A money market is a mechanism which makes it possible for borrowers and lenders to come together. Essentially it refers to a market for short term funds. It meets the short term requirements of the borrowers and provides liquidity of cash to the lenders.

Money market is the market in which short term funds are borrowed and lent. The money market does not deal in cash or money but in trade bills, promissory notes and government papers which are drawn for short periods. These short term bills are known as near money.

Importance of money market —

- Dealing in bills of exchange and commercial papers
- Acting as an outlet for the excess short term funds of commercial banks
- Dealing in treasury bills and short dated government securities
- Guiding central banking policies
- Making central banking policies effective
- Reduction of disparities in interest rates
- Influencing the capital market

(d) Despite the assertions of technical analysis, technical analysis is not a sure-fire method. The various limitations of technical pointed but by its critics are as given under :

i) Difficult in interpretation: Technical analysis is not as simple as it appears to be. While the charts are fascinating to look at, interpreting them correctly is very difficult. It is always easy to interpret the charts long after the actual point of time. As such, fundamentals argue that charting techniques are no different from palmistry.

ii) Frequent changes: With changes in market, chart patterns keep on changing. Accordingly, technical analysts change their opinions about a particular investment very frequently. One day they put up a buy signal. A couple of weeks later, they see a change pattern and put up a sell signal.

iii) Unreliable changes: Changes in market behaviour observed and studied by technical analyst may not always be reliable owing to ignorance or intelligence or manipulative tendencies of some participants.

iv) Judgemental Bias: A false piece of information or wrong judgment may result in trade at a lower than market price. If the technicians fail to wait for confirmation, they incur losses.

Question 4.

(a) What is Mezzanine Finance?

(b) Explain the procedures for buy back of its shares by a company.

(c) The unit price of RSS Scheme of a mutual fund is ₹ 10. The public offer price (POP) of the unit is ₹ 10.305 and the redemption price is ₹ 9.75. Calculate: (i) Front-end load, and (ii) Back-end load.

(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.

[2+7+6+5]

Answer:

(a) It is a generic term for financial instruments that have the characteristics of both debt and equity. It may be secured or unsecured, and it may or may not involve a degree of participation in the upside of sale of business. It usually comes in the form of variations on preference shares or loan stock. It is usually provided by mezzanine finance specialists to back management buy-outs and buy-ins.

(b) Procedure for buy back —

(i) Where a company proposes to buy back its shares, it shall, after passing of the special/Board resolution make a public announcement at least one English National Daily, one Hindi National daily and Regional Language Daily at the place where the registered office of the company is situated.

(ii) The public announcement shall specify a date, which shall be "specified date" for the purpose of determining the names of shareholders to whom the letter of offer has to be sent.

(iii) A public notice shall be given containing disclosures as specified in Schedule I of the SEBI regulations.

(iv) A draft letter of offer shall be filed with SEBI through a merchant Banker. The letter of offer shall then be dispatched to the members of the company.

(v) A copy of the Board resolution authorising the buyback shall be filed with the SEBI and stock exchanges.

(vi) The date of opening of the offer shall not be earlier than seven days or later than 30 days after the specified date.

(vii) The buyback offer shall remain open for a period of not less than 15 days and not more than 30 days. A company opting for buys back through the public offer or tender offer shall open an escrow Account.

(c) (i) Calculation of Front-end load

$$\text{Public Offer Price} = \frac{\text{Net asset value}}{1 - \text{Front} - \text{end load}}$$

Where, Public offer price ₹ 10.305; Net asset value ₹ 10, let Front-end load be F

$$10.305 = \frac{10}{(1 - F)}$$

10.305 (1-F) = 10

10.305 - 10.305F = 10

10.305F = 10.305 - 10

F = 0.305/10.305 = 0.0296
Therefore, Front-end load =2.96%

(ii) Calculation of Back-end load (B)

$$\text{Redemption Price} = \frac{\text{Net asset value}}{1 - \text{Back} - \text{end load}}$$

Where redemption price is ₹ 9.75 and let back-end load be B

$$9.75 = \frac{10}{(1-B)}$$

9.75 (1-B) = 10
9.75 - 9.75 B = 10
-9.75B = 10 - 9.75
B = 0.25/9.75 = 2.56%
Therefore, Back-end load = 2.56%

(d) 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
(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 one from the stated options and write it down:

(i) **ABC private company has reduced to a single member and continued business more than 6 months. The company's liability will be —**
A. Limited
B. Unlimited
C. No change in liability
D. All of the above

(ii) **Mr. Saha is a promoter of a company. Before the company is fully incorporated, he enters into a contract on its behalf with a third party. Under the common law, would a valid contract exist and, if so, who would be the parties to the contract?**
A. No contract would exist
B. A contract would exist and it would be between unformed company and the third party
C. A contract would exist and it would be between Mr. Saha and third party
D. A contract would exist and it would be between Mr. Saha and the company

(iii) **A public limited company may in the general meeting, resolve to capitalize any part of the amount standing to the credit of any of its reserve accounts, up to the recommendation of the —**
A. Managing director
B. Board of directors
C. Financial advisor
D. Shareholders

(iv) **After incorporation of a company, the first AGM (Annual General Meeting) should be held within:**
A. 12 months
B. 16 months
C. 18 months
D. 24 months

(v) **The term 'company' is defined under which section of the Companies Act, 1956?**
A. Sec 4(2)
B. Sec 5(4)
C. Sec 1(3)
D. Sec 3(1)

(vi) **Which of the following is not a characteristic of a company?**
A. Separate entity
B. Transferability of shares
C. Doctrine of ultra vires
D. Perpetual succession and common seal

[6 × 1]

(b) Fill in the blanks in the following sentences by using appropriate word(s)/phrase(s)/ number(s):

(i) **The _______________ was established in October 2003 under the Competition Act, 2002.**

(ii) **The Doctrine of ___________________ provides that an outsider must read the Memorandum and Articles of a company.**

(iii) **The objectives of the _________________ Act are to 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.

(iv) **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.**

[4 × 1]

Answer to Question 5(a):

(i) B. unlimited
(ii) C. contract would exist and it would be between Mr. Saha and third party
(iii) B. Board of directors
(iv) C. 18 months
(v) D. Sec 3(1)
(vi) C. Doctrine of ultra vires

Answer to Question 5(b):

(i) Competition Commission of India
(ii) Constructive Notice
(iii) Right to Information
(iv) Promoter

Question 6.

(a) **What are the procedures to be adopted for the alteration of object clause in the Memorandum?**
(b) **A company is not authorised by its Memorandum of Association to run a canteen but it is obliged to do so under Section 46 of the Factories Act, 1948. Under the facts and circumstances, should the company undergo the formalities of changing its objects clause?**
(c) **Write a brief note on Director Identification Number (DIN).**
(d) **What are the provisions to be maintained to issue debentures at a discount?**

[6+2+4+3]

Answer:

(a) 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) If the running of the canteen is incidental to the main object of the company, there is no necessity to amend the object clause, but if the purpose is to earn profit, then the object clause should contain enabling provision to carry on such business by suitably amending the memorandum in accordance with the law.

(c) According to section 266 A, 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 in case of director appointed before the commencement of the Companies (Amendment) Act, 2006.

Section 266 B 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.

(d) Debentures can be issued at a discount, unless the articles provide otherwise. There are no formalities required to be completed like the ones prescribed in case shares are issued at discount. But the particulars of the debentures issued at discount or any allowance or commission in relation to the debentures issued at a discount are to be filed with the Registrar for registration. Interest payable on debentures may be paid out of capital. Convertible debentures cannot be issued at a discount because it will be an indirect way of issuing shares at discount. A company cannot issue debentures carrying voting rights at any meeting of the company.

Question 7.

(a) What are the conditions to be satisfied in case of an amalgamation in the nature of merger?

(b) "It is now a universally accepted proposition of corporate governance practice that boards appoint appropriately composed remuneration committees to work out executive remuneration on their behalf." — Explain the responsibilities which are normally assigned and duties to be performed by a remuneration committee in this regard.

(c) You are required to examine with reasons whether the following transaction can be termed as loan to directors requiring the approval of the Central Government as required under section 295 of the Companies Act, 1956:
Sale of company's flat to a director at prevailing market price, out of which the director pays 50% (fifty per cent) immediately and contracts to pay balance amount in 10 equal annual installments.

[5+5+5]

Answer:

(a) Amalgamation in the nature of merger is such an amalgamation, which satisfies all the following conditions:

i. All the assets and liabilities of the transferor company become the assets and liabilities of the transferee company;
ii. Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than Transferee Company and its nominees) become equity shareholders of the transferee company after amalgamation;
iii. The consideration is to be discharged by way of issue of equity shares in the transferee company to the shareholders of the transferor company on the amalgamation;
iv. The business of the transferor company is to be carried on by the transferee company;
v. No adjustments are intended to be made to the book values of the assets and liabilities of the transferor company.

If any one or more of the aforesaid conditions are not satisfied then the amalgamation is in nature of purchase.

(b) The remuneration committee will be responsible for working out remuneration packages "to attract, retain and motivate executives of the quality required". The committee should decide where to position their company relative to other companies and take account of comparable remuneration and relative performance. With regard to the composition of the committee, an overwhelming majority of guidelines suggest that it be composed exclusively of independent non-executive directors. The committee would make its well considered recommendations to the board for final decision. The following responsibilities are normally assigned to a remuneration committee, which should have written terms of reference:

1) Remuneration packages and service contracts of the CEO and other senior executives.
2) Remuneration packages for non-executive directors.
3) Remuneration policies and practices of the company.
4) Any company share and other incentive schemes
5) Company superannuation and pension arrangements.

(c) As per section 295, a public company shall not, directly or indirectly, make any loan to a director without obtaining the previous approval of the Central Government. The debt in the instant case arose not out of an advance but out of a transaction of sale of a flat by the company to its director. The company gave time to the director to pay a part of the purchase price.

The essential requirement of a 'loan' is the advance of money upon the understanding that it shall be returned back and it may or may not carry interest. Where a company sells a flat to one of its directors and receives half the price in cash and agrees to receive the balance in installments, the transaction amounts to a credit sale; it does not amount to even an 'indirect loan'. The word 'indirectly' used in section 295 only means that company shall not give a loan to a director through the agency of one or more intermediaries. The word 'indirectly' cannot be read as converting what is not a loan into a loan. Therefore, the Court held that there was no contravention of section 295 [Dr. Fredie Ardeshir Mehta v Union of India (1991) 70 Comp Cos 210], However, the director shall disclose his interest (Section 299). He shall not participate in the discussion and shall not vote at the time of entering into the sale transaction. He shall not be counted in quorum (Section 300).

Question 8.

(a) What is Voluntary Winding Up? What are the methods involved in a Voluntary Winding Up?

(b) A company is registered in Kolkata and its head office is in New Delhi. Can the company make arrangement to issue shares from Patna? Explain.

(c) Internal control consists of five interrelated components. What are those components in Internal Control?

(d) Differentiate between Memorandum of Association and Articles of Association.

[4+2+5+4]

Answer:

(a) Voluntary winding up means winding up by the members of the company or creditors of the company without the interference by the Tribunal. The following are the methods of voluntary winding up:

(i) By passing a ordinary resolution: If there is a fixed period for which a company has been established as per the articles of association, the company may by passing an ordinary resolution in a general meeting decide to wind up after the expiry of the specified period.

(ii) By Special Resolution: A company may at any time pass a special resolution that it be wound up voluntarily. No reasons need by given where the members pass a special resolution for the voluntary winding up of the company. Even the articles cannot prevent the exercise of this statutory right.

(iii) A voluntary winding up shall be deemed to commence at the time when the resolution, either special or ordinary is passed for its voluntary winding up.

(iv) The company shall have to give a notice within 14 days of the passing of the resolution for voluntary winding up of the company by advertisement in the Official Gazette and also in some newspaper circulating in the district of the registered office of the company.

(b) A company which was registered in Kolkata with its head office in New Delhi can arrange to issue shares from Patna provided it is listed with a stock exchange situated in Bihar. The main criteria for issuing of shares is that a company can issue shares from any state, other than the state in which its registered office is situated, provided the company is listed with a stock exchange located in that state from where the company intended to issue the shares.

(c) Internal Control is a process — effected by an entity's board of directors, management and other personnel designed to provide reasonable assurance.

Internal control consists of the following five interrelated components.

1. Control Environment: It sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure.
2. Risk Assessment: It is the entity's identification and analysis of relevant risks to achievement of its objectives, forming a basis for determining how the risks should be managed.

3. Control activities: These are the policies and procedures that help ensure that management directives are carried out.
4. Information and Communication: It helps in are the identification, capture and exchange of information in a form and time frame that enable people to carry out their responsibilities.
5. Monitoring: It is a process that assesses the quality of internal control performance over time.

(d) The following is the difference between the Memorandum of Association and Articles of Association:

Memorandum of Association	Articles of Association
1. It is the charter of the company and indicates various things like name, objects, capital, liability etc.	1. They are the regulations for the internal management of the company.
2. It defines and confines the areas of operations of the company	2. Articles are the rule for carrying the objects of the company as set out in the Memorandum.
3. As it is a charter of the company, it is the supreme document.	3. They are subordinate to the Memorandum. In case of any conflict between the two, Memorandum shall Prevail.
4. Any act done by the company by going beyond the Memorandum is ultra virus and cannot be ratified even by whole of shareholders	4. Any act of the company, which is ultra virus the Articles can be ratified by the shareholders.