FINAL EXAMINATION

GROUP III

(SYLLABUS 2008)

SUGGESTED ANSWERS TO QUESTIONS

JUNE 2013

Paper- 11 : CAPITAL MARKET ANALYSIS & CORPORATE LAW

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) Open a new page for answer to a new question.
(3) Attempt the required number of question only.

SECTION - I (60 Marks)
(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.

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). **2x7=14**

(i) MR. DEBASHIS has formed a portfolio and the characteristics of his portfolio are given below:

Security	Sontex Ltd.	Polar Ltd.	Treasury Bill	Index Fund
Weight	0.07	0.25	0.25	0.43
Beta (β)	1.72	0.89	?	?

Beta of his portfolio is :

(A) 0.8229

(B) 0.7729

(C) 0.4629

(D) None of the above.

(ii) 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

(iii) The shares of NABANI 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

(iv) 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)

(v) Consider the following data of SUN INDIA MUTUAL FUND (Growth Plan):

Particulars	₹ In crore
Value of investments	2757.00
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) ₹ 20.74

(B) ₹ 20.81

(C) ₹ 21.41

(D) Insufficient information

(vi) BSE Index is currently quoting at 1620. Each lot is 300. MS ASHA, an investor purchases a July contract at 1710. She has been asked to pay 8% initial margin. What is the amount of initial margin required to be paid by her?

(A) ₹ 31,800

(B) ₹ 41,040

(C) ₹ 44,810

(D) None of the above

(vii) MR. MOHON has purchased a stock of MAXI OILS LTD. (MOL). Currently the company pays dividend of ₹ 8.50 per share. Thereafter the dividend is expected to grow at a constant rate of 6.5% p.a. the stock of MOL has beta of 1.40. If the risk free rate of return is 7.5% p.a. and the expected market return is 12% p.a., what would be the stock's expected price four years from now?

(A) ₹ 137.79

(B) ₹ 159.53

(C) ₹ 163.18
(D) None of the above

(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 think correct): 1x6=6

(i) The following Act empowers the government departments to accept filing, creating and retention of official documents in the digital format:
(A) Indian Companies Act, 1956
(B) E commerce Act, 2011
(C) Information Technology Act, 2000
(D) None of the above

(ii) The Board for Financial Supervision (BFS) was constituted in November, 1994 as a Committee of:
(A) The Ministry of Finance
(B) The Central Board of Directors of the RBI
(C) The Ministry of Company Affairs
(D) Incomplete information

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

(iv) Which of the following statements is/are true?
(A) If market price = face value, then Coupon Rate > YTM > Current Yield
(B) If market price < face value, then Coupon Rate > Current Yield > YTM
(C) If market price > face value, their Coupon Rate > Current Yield > YTM
(D) If market price = face value, then Coupon Rate < Current Yield < YTM

(v) Which of the following option strategies involve the purchase of call options and writing of put options are exactly the same exercise price?
(A) Synthetics
(B) Spreads
(C) Conversions
(D) None of the above

(vi) 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 1.

(a) (i) B:0.7729

Beta of the Portfolio:

0.07 x 1.72 + 0.25 x 0.89 + 0.25 x 0 + 0.43 x 1 = 0.7729

(ii) B: 862.50 crore

New Base year Average:

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

= 750 x (1200 + 180) ÷ 1200 = 862.50 Crore

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

(iv) 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%.

(v) A: ₹ 20.74

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

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

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

(vi) B: ₹ 41040
The closing price for the Spot Index was 1620. The Rupee value of stocks is thus 300 x 1620 = ₹ 486000.
The closing features price for the July contract = 1710.
Rupee value of stocks = 1710 x 300 = ₹ 513000
Margin Requirement @ 8% is : 0.08 x 513000 = ₹ 41040.

(vii) B: ₹ 159.53
Return on equity (K_e) = 7.5 + (12 – 7.5) 1.40 = 13.80%
Value of stock (p_4) = $D_0 (1+g)^5 / (K_e - g)$
= $8.5 (1.065)^5 / (0.1380 - 0.065)$
= (11.646) / (0.073) = ₹ 159.53

(b) (i) C
(ii) B
(iii) C
(iv) C
(v) A
(vi) A

2. (a) Briefly discuss about the two categories of underwriters in India. 6

(b) MR. GOPAL KUTTY established the following spread on the SOFTEX LTD.'S stock:

(i) Purchased one 3 month Call Option with a premium of ₹ 5.25 and an exercise price of ₹ 475.00

(ii) Purchased one 3 month Put Option with a premium of ₹ 3.50 and an exercise price of ₹ 425.00

The current price of Softex Ltd.'s stock is ₹ 451.00

You are required to determine Mr. Gopal Kutty's profit or loss if—

(A) The Price of Softex Ltd.'s stock stays at ₹ 451.00 after 3 months

(B) The Price of Softex Ltd.'s stock falls to ₹ 401.00 after 3 months

(C) The Price of Softex Ltd.'s stock rises to ₹ 476.00 after 3 months

[Market lot of each contract is 650 shares] 3+2+2=7

(c) MS. NABANITA, during the initial offer of TEMPLAN MUTUAL FUND, invested in 10000 units having face value of ₹ 10 for each unit on 1st August, 2010. The dividend operated by the Templan Mutual Fund was 10% on 31.3.2011 and Ms. Nabanita found that her annualised yield was 180%. On 31.12.2012, 25% dividend was given by the Mutual Fund (Templan).
Ms. Nabanita redeemed all her balance of 11384*664 units on 31.3.2013, when her annualized yield was 80%. (Assume that dividends were reinvested)
Required:
What are the NAVs as on 31.3.2011, 31.12.2012 and 31.3.2013? 2+2+2+1 =7

Answer 2.

(a) Categories of underwriters in India

The underwriters in India may be classified into two categories:

- Institutional underwriters
- Non-institutional underwriters

The institutional underwriters are

- Life Insurance Corporation of India (LIC)
- Unit Trust of India (UTI)
- Industrial Development Bank of India (IDBI)
- Industrial Credit and Investment Corporation of India (ICICI)
- Commercial Banks and general insurance companies.

The pattern of underwriting of the above institutional underwrites differs vastly in India. LIC and UTI have purchased industrial securities from the new issue market with a view to hold them on their own portfolio. They have a preference for underwriting shares in large and well established firms. The development banks have given special attention to the issues in backward states and industries in the priority list. The thrust of the development banks is also towards small and new issues which do not have adequate support from other institutions. General insurance companies have shown preference in underwriting the securities of fairly new issues.
The non-institutional underwriters are brokers. They guarantee shares only with a view to earn commission from the company floating the issue. They are known to-off load the shares later to make a profit. The brokers work profit motive in underwriting industrial securities. After the elimination of forward trading, stock exchange, broker have begun to take an underwritten to the private capital issue varies between 72 per cent to 97 per cent.

(b) total premium paid on purchasing a call and put option:
= (₹ 5.25 per share x 650 + ₹ 3.50 per share x 650)
= ₹ 3412.50 + ₹ 2275 = ₹ 5687.50

(i) (A) In the case, Mr. Gopal Kutty exercises neither call option as both will result in a Loss for him.
Ending Value = ₹ 5687.50 – Zero gain
= ₹ 5687.50 i.e. Net Loss = ₹ 5687.50

(B) Since the price of the stock is below the exercise price of the call, the call will not to be exercised.
Only Put is valuable and is exercised.
Total Premium paid = ₹ 5687.50
Ending Value = ₹ (425 – 401) x (650) – Rs 5687.50
= ₹ (15600 – 5687.50)
Therefore, Net gain = ₹ 9912.50

(C) In this situation, the Put is Worthless, since the price of the stock exceeds the put's exercise price.
Only call option is valuable and is exercised.
Total Premium Paid = ₹ 5687.50
Ending Value = ₹ 5687.50 – ₹ (476 – 475) x (650)
= ₹ 5687.50 – ₹ 650
= ₹ 5037.50
Therefore, New Loss: ₹ 5037.50

(c)

Date of Investment	Action	NAV	Units Hold	Return
01.08.2010	Original Purchase	₹ 10.00	10000	--
31.03.2011	Dividend 10%	?	?	180%
31.12.2012	Dividend 25%	?	?	--
31.03.2013	Full Redemption of Units	?	0	80%

As on 31.03.2011: Annualized yield of 180%
Therefore, we have as follows:

$$\text{Annualized yield} = \frac{\text{Closing Value (NAV) - Opening NAV}}{\text{Original NAV}} \times \frac{12}{n} \times 100$$

For 8 months period from the beginning:

$$= \frac{\text{clg NAV - 10}}{10} \times \frac{12}{8} \times 100 = 180$$

Solving we get closing value (NAV) as on 31.03.2011 : ₹ 22.00 (cum dividend of 10%)

Hence, Units as on 31.03.2011.
10000 + (10000 ÷ 22) = 10454.545 units

Payment of 25% as dividend on 31.03.2012
= 10454.545 x 2.50 = ₹ 26136.36

∴ Total units would be equal to 11384.664 (as on 31.03.2013)

NAV as on 31.12.2012 will be (26136.36 ÷ 960.119) = ₹ 28.10
(11384.664 – 10454.545) = 930.119

Now we are given Annualized yield as on 31.03.2013 = 80%

Using the formula we find the closing NAV as on 31.03.2013

$$80 = \frac{(\text{clg NAV - Rs. 28.10})}{28.10} \times \frac{12}{3} \times 100 = \frac{(\text{clg NAV - 28.10}) \times 400}{28.10}$$

Or Clg NAV = $\frac{13488}{400}$ = ₹ 33.72 (as on 31.03.2013)

Thus the required NAV as on
(i) 31.03.2011 : ₹ 22.00
(ii) 31.12.2012 : ₹ 28.10
(iii) 31.03.2013 : ₹ 33.72

3. (a) The Information Technology Act 2000, though appears to be self sufficient, takes mixed stand when it comes to many practical situations.
Outline few places where it looses its certainty. 5

(b) MR. ABHISHEK an analyst at ASHLEEN SECURITIES LTD. is evaluating the prospects of

investing in two companies SPARK LTD. and ELECTRA LTD. The projects of returns for the stocks of these two companies along with their probabilities are as follows:

Probability	Returns associated with (in %)	
	Spark Ltd.	Electra Ltd.
0.20	90	11
0.10	75	29
0.30	60	33
0.25	20	60
0.15	30	55

You are required

(i) Calculate the expected returns, standard deviations of returns and Correlation Co efficient between the two stocks.

(ii) Compare the risk and return of these two stocks with a portfolio of these stocks in equal proportions.

(iii) Determine the expected rate of Return of a ZERO RISK portfolio consisting of the above two stocks. **6+4+5=15**

Answer 3.

(a) **Is the IT Act, 2000 self-sufficient?**

The IT Law 2000, though appears to be self sufficient, it takes mixed stand when it comes to many practical situations. It looses its certainty at many places like:

1. The law misses out completely the issue of Intellectual Property Rights, and makes no provisions whatsoever for copyright trade marking or patenting of electronic information and data. The law even doesn't talk of the rights and liabilities of domain name holders, the first step of entering into the e-commerce.

2. The law even stays silent over the regulation of electronic payments gateway and segregates the negotiable instruments from the applicability of the IT Act, which may have major effect on the growth of e-commerce in India. It leads to make the banking and financial sectors irresolute in their stands.

3. The act empowers the Deputy Superintendent of Police to look up into the investigations and filling of charge sheet when any case related to cyber law is called. This approach is likely to result in misuse in the context of Corporate India as companies have public offices which would come within the ambit of "public place" under the Act. As a result, companies will not be able to escape potential harassment at the hands of the DSP.

4. Internet is a borderless medium; it spreads to every corner of the world where life is possible and hence is the cyber criminal. Then how come is it possible to feel relaxed & secured once this law is enforced in the nation.

(b)

Probability (P_i)	SPARK LTD. (%)				ELECTRA LTD. (%)			
	Expected Return ₹	(P_t x R_s)	($R_s - \overline{R_s}$)	VARs $(R_s - \overline{R_s})^2$x P_i	Expected Return RE	(P_t x R_E)	($R_E - \overline{R_E}$)	VARs $(R_E - \overline{R_E})^2$x P_i
0.20	90	18.00	37	273.8	11	2.2	-27.25	148.51
0.10	75	7.50	22	48.4	29	2.9	-9.25	8.56
0.30	60	18.00	7	14.70	33	9.9	-5.25	8.27
0.25	20	5.00	-33	272.25	60	15.0	21.75	118.27
0.15	30	4.50	-23	79.35	55	8.25	16.75	42.08
		53.00		688.50		38.25		325.69

Expected Returns of SPARK LTD. $(\overline{R_s})$ = 53.00%

Expected Returns of Electra Ltd ($\overline{R_E}$) = 38.25%

Standard Deviation of Return for Spark Ltd. = $\sigma_S = \sqrt{688.50}$ = 26.24%

Standard Deviation of Return for Electra Ltd. = $\sigma_E = \sqrt{325.69}$ = 18.05%

Covariance between two stocks

Probability	$(R_S - \overline{R_S})$	$(R_E - \overline{R_E})$	COV(SE) $P_i(R_S - \overline{R_S}) \times (R_E - \overline{R_E})$
0.20	37	-27.25	-201.65
0.10	22	-9.25	-20.35
0.30	7	-5.25	-11.03
0.25	-33	21.75	-179.44
0.15	-23	16.75	-57.79
			-470.26

Correlation co-efficient between two stocks (Spark & Electra):

$$\frac{COV(SE)}{\sigma_S \ \sigma_E} = \frac{-470.25}{(26.24)\times(18.05)} = -0.9929 = -1.00$$

(ii) The risk and Return of Port folio of two stocks:

RISK:

$\sigma_p^2 = (0.5^2) \times 688.50 + (0.5^2) \times 325.69 + [2x - 1 \times 26.24 \times 18.05 \times 0.5 \times 0.5]$

= 172.125 + 81.422 – 236.816 = 16.731

Risk (σ_P) = $\sqrt{16.731}$ = 4.09%

Expected Return: E (R_P)= (0.50 x 26.24) + (0.50 x 18.05)

= 13.12 + 9.025 = 22.145 i.e. 22.15%

Hence, the Return is 22.15% with the risk of 4.09% for the Port folio. Thus the Portfolio results in risk reduction by the Combination of two risk securities (spark & Electra)

(iii) Since the Correlation co-efficient between two stocks (spark & Electra) is -1, a Zero-Risk Portfolio can be constructed using these Stocks.

If W1 and W2 is the proportion of investment in Spark & Electra Stocks, the Portfolio risk will be

$\sigma_p^2 = (W_1)^2 + \sigma_S^2 + (W_2)^2 \sigma_E^2 + 2\, \rho_{SE} \times \sigma_S \times \sigma_E \times W_1 \times W_2$

$\sigma_p^2 = (W_1\sigma_S)^2 + (W_2\sigma_E)^2 + 2(-1) W_1\sigma_S \times W_2\sigma_E$

$\sigma_p^2 = (W_1\sigma_S)^2 + (W_2\sigma_E)^2 - 2W_1\sigma_S\, 2W_2\sigma_E$

$= (W_1\sigma_S - W_2\sigma_E)^2$

$= \sigma_p = W_1\sigma_S - W_2\sigma_E$ [ZERO RISK = 0 □ σ_P = 0

$O = W_1\sigma_S - W_2\sigma_E$

Or $W_1\sigma_S = W_2\sigma_E$ ----- (i)

Again $W_1 + W_2 = 1$ or, $W_2 = 1 - W_1$ ----- (ii)

Putting the value of W_2 in equation No. (i)

$W_1\sigma_S = (1 - W_1)\sigma_E$

Or 26.24 W_1=(1-W_1) 18.05 = 18.05 – 18.05 W_1

Or (26.24 + 18.05) W_1= 18.05

Or 44.29 W_1= 18.05

Or, W_1=(18.05 ÷44.29) = 0.4075 i.e. 40.75%

W_2 = 1 – 0.4075 = 0.5925 i.e. 59.25%

Expected Return of RISK FREE PORT FOLIO (ZERO-RISK PORT FOLIO):

26.24 x 0.4.075 + 18.05 x 0.5925

= 10.693 + 10.695 = 21.39%

4. (a) What do you mean by ETF (Exchange Traded Funds)? State in brief the applications of it. 2+4=6

(b) ZENITH TEXTILES LTD. (ZTL) has under consideration refunding of ₹ 3 crore outstanding Bonds at ₹ 1000 per value as a result of recent decline in long term interest rates. The bond refunding plan involves issue of ₹ 3 crore of New Bonds at the lower interest and the proceeds to call and retire the ₹ 3 crore outstanding bonds.
The details of the new bonds are:
(i) Sale at per value of ₹ 1000 each
(ii) 11 per cent coupon rate
(iii) 20 years maturity
(iv) Floatation costs ₹ 4,00,000 and
(v) A 3 month period of overlapping interest

ZTL's outstanding Bonds were initially issued 10 years ago with a 30 year maturity and 13 per cent coupon rate of interest.

They were sold at ₹ 12 per bond discount from per value with floatation costs amounting to ₹ 1,50,000 and their call at ₹ 1,130.
ZENITH's Marginal tax rate is 35 per cent.

Required:
(i) Analyse the Bond refunding proposal.
(ii) Would you recommend it? Why?

Note:
Extracted from the Table of PV

Interest rate	7%	7.15%	8.45%	11%	13%
PVIF (20 years)	0.25842	0.25128	0.19743	0.12403	0.08678
PVIFA (20 years)	10.59401	10.47161	9.49787	7.96336	7.02477

3+3+2+1=9

(c) Identify the hedging strategies that would be required using the Index Futures under the following circumstances:

Stock	Position	Beta	No. of shares	Price (₹)	Hedge needed
SBI	Long	1.30	1000	1900	Full
RIL	Long	1.20	1000	800	Full
BHEL	Short	1.10	1000	300	90%
TSL	Short	0.80	1000	400	80%
Infosys	Long	1.00	1000	1800	120%

2+3=5

Therefore, higher the Beta higher will be the hedge ratio i.e., the value or futures position would be proportionately be higher and vice-versa. Also the need for full or partial hedging would also have a bearing on the amount of Future exposure.

Futures position = Beta x No. of Shares x Price x % Hedging Required
For the first Case = 1.30 x 1000 x 1900 x 1.00 = ₹ 24.70 Lakh.

Stock	Original Position	Beta	No. of Shares	Price (₹)	Hedge Needed	Hedge Position	Future Strategy (₹) in Lakh	
SBI	Long	1.30	1000	1900	Full	Short	Short	24.70
RIL	Long	1.20	1000	800	Full	Short	Short	9.60
BHEL	Short	1.10	1000	300	90%	Long	Long	2.97
TSL	Short	0.80	1000	400	80%	Long	Long	2.56
Infosys	Long	1.00	1000	1700	120%	Short	Short	20.40

Answer:

4. (a) Exchange Traded Funds (ETF) are just what their name implies: baskets of securities that are traded, like individual stocks on an exchange, Unlike regular open-end Mutual Funds, ETF, 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. But once it was done, the volumes took off with a retaliation. Most ETFs change lower annual expenses than index Mutual funds. However, as with Stocks, one must pay brokerage to buy and sell ETF units, which can be a significant drawback for those who trade frequently or invest regular sums of money. The funds rely on an arbitrage mechanism to keep the prices at which they trade roughly in line with the net asset values of their underlying portfolio.

Application of Exchange Traded Funds (ETF) are:

(i) **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.
(ii) **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 reduce risk.
(iii) **Efficient Trading**: ETFs provide investors a convenient way to gain market exposure viz. an index that trades like a stock.
(iv) **Shorting or Hedging**: ETFs may be sold short against long stock holdings as a hedge against a decline in the market or specific sector.
(v) **Filling Gap**: ETFs tried to a sector or industry may be used to gain exposure to new and important sectors.
(vi) **Equitising Cash**: Investors having idle cash in their portfolios, may want to invest in a product tied to a market bench mark. An ETF is a temporary investment before deciding which stock s to buy or waiting for the right price.

(B)

ZENITH TEXTILES LTD.

1. Initial investment:

	Particulars	₹	₹
(a)	Call Premium: Before Tax (₹ 1130 – 1000) x 30000 Bonds Less : Tax (0.35 x 3900000) Cost of Call Premium (after Tax)	3900000 1365000	2535000

(b)	Floatation Cost of New Bond		400000
(c)	Overlapping Interest: Before Tax (0.13 x 3/12 x 30000000 Less : Tax (0.35 x 975000) Cost of overlapping Interest (after Tax)	 975000 341250	 633750
(d)	Tax Savings from Unamortised discount on old Bonds [20/30 x (30000 x ₹ 12 per Bond discount] x 0.35		 (84000)
(e)	Tax savings from Unamortized Floatation Cost of old bonds [20/30 x (150000 x 0.35)]		(35000)
	Initial Outlay:		**3449750**

2. Annual net cash flow savings:

	Particulars	₹	₹	₹
(a)	Old Bonds: (i) Interest Cost: Before Tax (0.13 x ₹ 3 Crore) Less: Tax (0.35 x 3900000) Interest Cost (After Tax)	 3900000 1365000	 2535000	
	(ii) Tax Saving from Amortization of discount [(30000 x 12) ÷ 30] x 0.35 (iii) Tax Savings from Amortization of Floatation cost ₹ [15000 ÷ 30] x 0.35 Annual debt Payment [After Tax]		 (4200) (1750)	 2529050
(b)	New Bonds (i) Interest Cost: Before Tax (0.11 x 30000000) Less: Tax (0.35 x 3300000) Interest Cost (After Tax) (ii) Tax savings from Amortisation of floatation cost (₹ 400000 ÷ 20) x 0.35 Annual Debt Payment (After Tax) Annual Net Cash Flow Savings (a-b)	 3300000 1155000	 2145000 (7000)	 2138000 391050

ANALYSIS FOR BOND REFUNDING DECISION:

	₹
Present Value (PV) of Annual Net Flow Savings: (391050 x 10.47164) [PVIFA (7.15% 20 Years)]	 4094923
Less: Initial Outlay	3449750
Net present Value of Refunding	**645173**

Decision: As the Net Present Value (NPV) of Refunding is positive, the Proposed Bond – Refunding may be recommended.

(c) The basic hedging Strategy is to take an equal and opposite position in the Futures market as compared to the Spot Market. Thus, if the Current Position is long, then one would short in the Futures Market and vice-versa. Secondly, if one were to use index Futures to hedge, then the relevant hedge Ratio is the beta of the respective Stock.

Therefore, higher the Beta higher will be the hedge ratio i.e., the value of futures position would be proportionately be higher and vice-versa. Also the need for full or partial hedging would also have a bearing on the amount of Future exposure.

Future Position = Beta x No. of Shares x Price x % hedging Required

For the first Case = 1.30 x 1000 x 1900 x 1.00 = ₹ 24.70 Lakh

Stock	Original Position	Beta	No. of Shares	Price (₹)	Hedge Needed	Hedge Position	Futures Strategy (₹) in Lakh	
SBI	Long	1.30	1000	1900	Full	Short	Short	24.70
RIL	Long	1.20	1000	800	Full	Short	Short	9.60
BHEL	Short	1.10	1000	300	90%	Long	Long	2.97
TSL	Short	0.80	1000	400	80%	Long	Long	2.56
Infosys	Long	1.00	1000	1700	120%	Short	Short	20.40

SECTION II (40 Marks)
(Corporate Laws)

Answer Question No. 5 (carrying 10 marks) which is compulsory and answer any two (carrying 15 marks each) from the rest in this Section.

5. (a) Choose the most appropriate one from the stated options and write it down (only indicate A or B or C or D as you think correct). 1x5=5

(i) There are 11 directors in GROW WELL LTD. a Public Limited Company. It has a Managing Director and a nominee of IDBI. How many directors are liable to retire by rotation?
(A) Four
(B) Six
(C) Seven
(D) Eight

(ii) 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

(iii) The nationality of a company is decided by:
(A) Place of residence of the directors in charge of management of the company
(B) Place of registered office of the company
(C) Place where the books of accounts of the company are kept
(D) None of the above

(iv) Prospectus is not required to issued by/in respect of:
(A) Private limited company
(B) Sweat equity shares
(C) Rights issue
(D) For all of the above

(v) Under the RTI Act, A second appeal against the decision of Public Information Officer shall lie within ___________ from the time by which the decision should have been made or receipt of a decision, prefer an appeal to the relevant Information Commissioner, (Fill in the gap from the below):
(A) 30 days
(B) 60 days
(C) 90 days
(D) None of the above

(b) Fill in the Blanks in the following sentences by using appropriate word(s)/phrase(s)/ number(s): 1x5=5

(i) The key features of Corporate Governance are given in section ____________of the

Companies Act, 1956.
(ii) The Competition Commission of India was established in the year _____ .
(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) An applicant for access to information________ (shall/shall not) be required to give any reason for requesting access to that information.
(v) As per clause 49 of the listing agreement, independent directors should account for atleast ________% of board of directors of listed companies.

Answer:

5. (a) (i) C
(ii) B
(iii) B
(iv) D
(v) C

(b) (i) 292A
(ii) 2003
(iii) 7
(iv) Shall not
(v) 50%

6. (a) JUPITERTEXTILES LTD. was incorporated on 1st June, 2009. On 1st March, 2012 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 April, 2009?
(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? 2+1+2+2=7

(b) State the importance of going Concern Concept in preparation of Corporate Financial Statements in India. How is the term' Foreseeable future' defined in this context? 6+2=8

Answer:

6. (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, 2012, 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 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)

Management may not prepare financial statements applying going concern basis in case there exists significant doubt about the going concern status of the enterprises. The point has not been taken care of in Section 217 (2AA).

In India preparation and presentation of Corporate financial statements are governed by accounting policies stated in the companies Act and any other status that govern the reporting entity, accounting standards and other documents stating accounting policies, measurement and disclosure issued by the institute of Chartered Accountants of India or any other regulatory authority like SEBI, RBI, IRDA etc. they together form Indian GAAP. In fact while preparing Financial Statements it is necessary to follow Indian GAAP.

Corporate financial statements are prepared following "going concern" assumption which implies that the reporting entity is expected to continue operations in the foreseeable future and it has neither the intention nor necessity of liquidation or of curtailing the scale of operations. In India the Corporate management is not required to make explicit disclosure as regards the validity of going concern assumption. The term foreseeable future is also not defined in the accounting standard. Considering the uncertainties involved in the predication of business continuity, foreseeable future should not taken as distant future.

Parameters of identifying going concern uncertainty:
Forecasts and budgets
Borrowings requirement
Liability management
Contingent liabilities
Product and markets
Financial risk management

Other factors including consistency of earning, stability of cost base, recurring operating losses, arrears of dividends, work stoppage, etc.

The Institute of Chartered Accountants of India has issued SAP – 16 Going Concern. This audit standard attempts to capture going uncertainty in the line of ISA – 23. Generally, financial statements are prepared on the basis of fundamental assumption of going concern. It is necessary for the auditors to consider the appropriateness of the going concern assumptions. The auditors should consider the existence of the following indications which risks the going concern Assumption:

Financial Indications

1. Negative net worth or negative working capital
2. Fixed term borrowing approaching maturity without realistic prospects of renewal or repayment or excessive reliance on short term borrowings to finance long term assets.
3. Adverse key financial ratios

4. Substantial operating losses
5. Substantial negative cash flow from operations
6. Arrears or discontinuance of dividends
7. Inability to pay creditors on due dates
8. Difficulty in complying with the terms of long agreements
9. Change from credit to cash on delivery transaction with suppliers.
10. Inability to obtain financing for essential new product development or other essential investments.
11. Entering into scheme of arrangement with Creditors for reduction of Liability.

Operating Indications:

1. Loss of key management without replacement.
2. Loss of a major market, franchise, License, or principle Supplier.
3. Labour difficulties or shortage of important supplies.

Other Indications:

1. Non Compliance with Capital or other Statutory requirements.
2. Pending legal proceedings against the entity may if successful result in Judgments that could not be met.
3. Changes in Legislation or Government policy.
4. Sickness of the entity under any statutory definition.
5. The Significance of such dedications can often be mitigated by other factors.

To resolve the doubt about the appropriateness of the going concern assumption the auditor should gather sufficient audit evidence.

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, 2004? 4

(b) Hon'ble Justice Mr. H. JALAN, a retired High Court Judge, attained the age 61 years on 31st December, 2011. The Central Government appointed him as the Chairperson of the Competition Commission of India with effect from 1st January, 2012. 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

(c) Briefly sketch the requirements of Section 292A of the Companies Act, 1956 relating to Audit Committee. 7

Answer:

7. (a)

Section 6(1) of the RTI Act 2004 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:

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

In KOLKATA, Bengal 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)

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 no Chairperson or other Member shall hold office as such after he has attained-

(a) In the case of the Chairperson, the age of sixty-seven years;
(b) In the case of any other Member, the age of sixty-five years.

Based on the above provisions of the Competition Act, 2002, it can be concluded that Hon'ble retired Justice 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 67 years as on 31st December, 2017, he will have to step down from the post on his attaining the age of 67 years.

(c)

Audit Committee

- Every public company having paid-up capital of not less than five crores of rupees shall constitute a committee of the Board known as "Audit Committee" which shall consist of less than three directors and such number of other directors other than managing or whole-time directors.
- Every Audit Committee constituted under sub-section(I) shall act in accordance with times of reference to be specified in writing by the Board.
- The members of the Audit Committee shall elect a chairman from amongst themselves.
- The annual report of the company shall disclose the composition of the Audit Committee.
- The auditors, the internal auditor, if any, and the director-in-charge of finance shall attend and participate at meetings of the Audit Committee but shall not have the right to vote.
- The Audit Committee should have discussions with the auditors periodically about internal control systems, the scope of audit including the observations of the auditors and review the half-yearly and annual financial statements before submission to the Board and also ensure compliance of internal control systems.
- The Audit Committee shall have authority to investigate into any matter in relation to the items specified in this section or referred to it by the Board and for this purpose, shall have full access to information contained in the records of the company and external professional advice, if necessary.
- The recommendation of the Audit Committee on matter relating to Financial Management including the audit report shall be binding on the Board.
- If the Board does not accept the recommendations of the Audit Committee, it shall record the reasons therefor and communicate such reasons to the shareholders.

- The Chairman of the Audit Committee shall attend the annual general meetings of the company to provide any clarification on matters relating to audit.
- If a default is made complying with the provision of this section, the company and every officer who is in default, shall be punishable with imprisonment for a term which may extend to one year, or with fine which may extend to fifty thousand rupees or with both.

8. (a) At the time of winding up of SIMON HOTEL LTD. (SHL), a supplier of company named MKG LTD., presents to the official liquidator, a Court decree in their favour ordering payment of certain sum. The claim of MKG LTD. is that they should be paid in preference over the claims of the workmen for their dues. The same is not accepted by the workmen.

Examine the validity of the rival claims in the light of the provisions of the Companies Act, 1956. 6

(b) " A good CORPORATE GOVERNANCE should have certain basic principles"— Enumerate them. 6

(c) VKS TEXTILES PVT. LTD., which is a private company which is not a subsidiary of any public company, does not furnish the details of its investments in Indian companies as required by note (1) Schedule VI to the Companies Act, 1956. The company is of the view that Section 372 of the Companies Act, 1956 is not applicable in its entirety to all the companies, i.e. public and private.

Is the said view of VKS TEXTILES PVT. LTD. in accordance with law? 3

Answer:

8. (a) **Preferential dues during winding up proceedings**

The situation given in the question is covered by the provisions of Section 529A of Companies Act, 1956 read with Section 529 and 523 of the said Act. The effect of combined reading of these sections is that the workmen of the company become secured creditors by operation of law to the extent of the workmen's dues and are entitled to proportional payment along with other secured creditors.

If there is no secured creditor, in such an event, to the extent of workmen's dues, the workmen of the company become unsecured preferential creditors under Section 529A. the object of section 529A is to ensure that the

(a) Workmen should not be deprived of their legitimate claims in the event of the liquidation of the company.
(b) The assets of the company would remain charged for the payment of workmen's dues, and
(c) Such charge will be pari passu with the charge of other secured creditors.

There is no other statutory provision overriding the claim of the secured creditors except the said Section 529A.

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

In view of the above stated legal position, the contention of the-workmen of SUMON HOTEL LTD. is valid and the Official Liquidator will have to pay their dues as provided in Section 529A of the Act.

(b) **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 committee to look after different matters. There can be following committees – (a) Audit Committee, (b) Grievance Committees, (c) Remuneration Committee and (d) Investment Committee etc.

(a) **Audit Committee** – It should meet periodically to review the effectiveness of the system of internal controls and reports to shareholders.

(b) **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.

(c) **Remuneration committee** – Its role should be to fix remuneration of non-executive directors. It may be fixed in relation to company performance.

(d) **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 worker's 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.

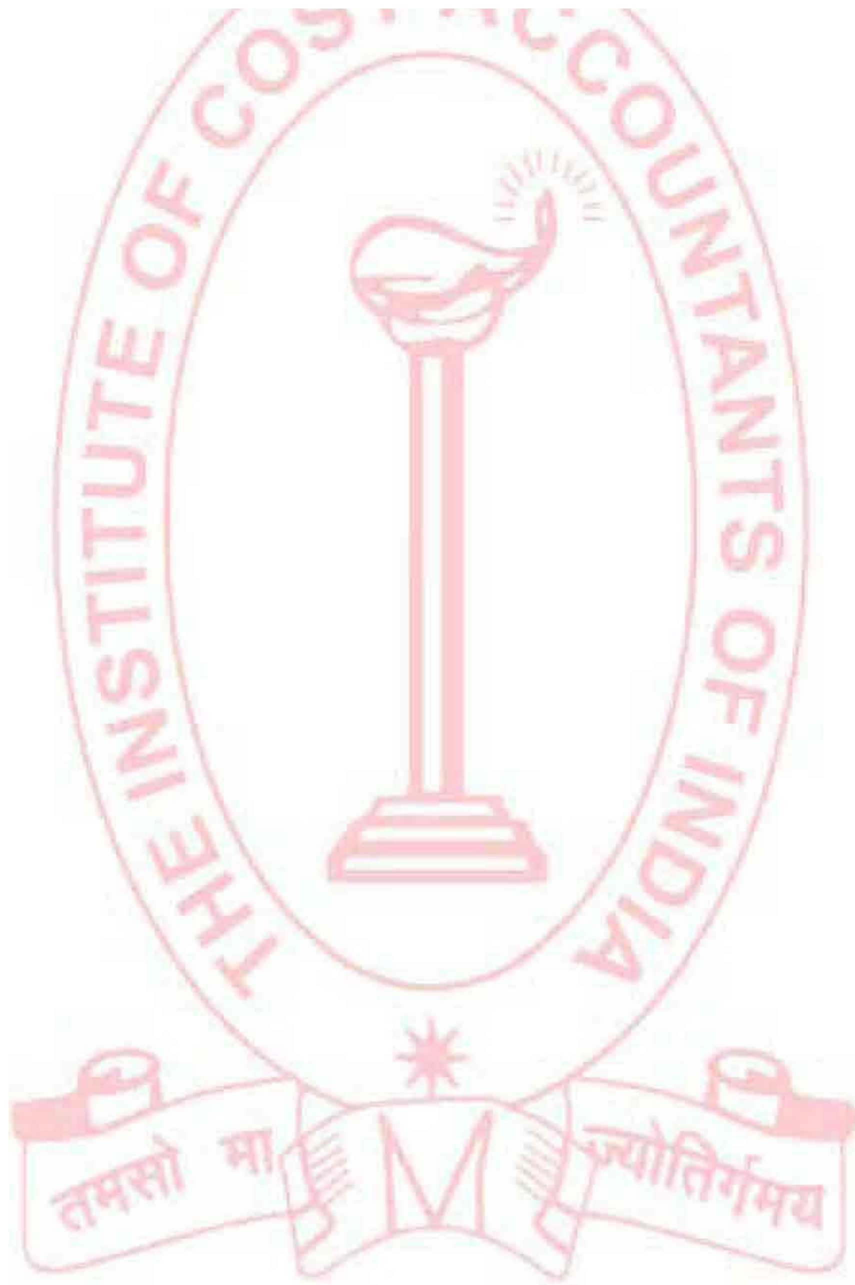
Good corporate governance calls for accountability for all Concerned. The Shareholders, Directors, auditors, executives, advisers and other staff who are associated with the working of the corporate should combined their efforts to improve the system and ensure good management practices.

(c) **Disclosure of investments by a private company**

Section 211 of the Companies Act, 1956 states that balance sheet of a company shall, subject to the provision of this section, be in the form set out in Part I of Schedule VI or as near thereto or as per central government directions in a particular case.

No exemption is given for private company as such. The exemption from compliance with any of the requirements in Schedule VI can be granted to any company by the central government when it is in the public interest.

In the given case the contention of the private company is not in accordance with law.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