

**FINAL COURSE**  
**GROUP – I**

**REVISION TEST PAPERS**

**MAY, 2024**



**BOARD OF STUDIES**

**THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA**  
*(Set up by an Act of Parliament)*

**New Delhi**

© The Institute of Chartered Accountants of India

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, in any form, or by any means, electronic, mechanical, photocopying, recording, or otherwise, without prior permission, in writing, from the publisher.

Edition : February, 2024

Website : [www.icaai.org](http://www.icaai.org)

Department/Committee : Board of Studies

E-mail : [bosnoida@icaai.in](mailto:bosnoida@icaai.in)

Price :

ISBN No. :

Published by : The Publication Department on behalf of  
The Institute of Chartered Accountants of India,  
ICAI Bhawan, Post Box No. 7100, Indraprastha  
Marg, New Delhi- 110 002, India

Typeset and designed at Board of Studies.

Printed by :

# Contents

*Page Nos.*

**Objective & Approach**..... *i – vi*

*Objective of RTP*..... *i*

*Planning & Preparing for Examination*..... *ii*

*Subject-wise Applicability*..... *iii*

## **Paper-wise**

Paper 1: Financial Reporting ..... 1 – 41

Paper 2: Advanced Financial Management.....42 – 72

Paper 3: Advanced Auditing, Assurance and Professional Ethics ..... 73 – 99

**Applicability of Standards/Guidance Notes/Legislative Amendments etc.  
for May, 2024 – Final Examination**..... 100 – 101

## **REVISION TEST PAPER, MAY, 2024 – OBJECTIVE & APPROACH**

***(Students are advised to go through the following paragraphs carefully to derive maximum benefit out of this RTP)***

### **I. Objective of Revision Test Paper**

Revision Test Papers are one among the many educational inputs provided by the Board of Studies (BOS) to its students. Popularly referred to as RTP by the students, it is one of the very old publications of the BOS whose significance and relevance from the examination perspective has stood the test of time.

The primary objectives of the RTP are:

- To help students get an insight of their preparedness for the forthcoming examination;
- To update them on the latest developments relevant for the forthcoming examination in select subjects;
- To enhance the confidence level of the students adequately.

Students must bear in mind that the RTP contains a variety of questions based on different topics of the syllabi and thus a comprehensive study of the entire syllabus is a pre-requisite before answering the questions of the RTP. In other words, in order to derive maximum benefit out of the RTPs, it is advised that before proceeding to solve the questions given in the RTP, students ought to have thoroughly read the Study Materials and Statutory Update/Judicial Update, wherever applicable.

The topics on which the questions are set herein have been carefully selected and meticulous attention has been paid in framing different types of questions. Detailed answers are provided to enable the students to do a self-assessment and have a focused approach for effective preparation.

Live Learning Classes by renowned subject experts conducted free of charge in virtual mode for the students of Foundation, Intermediate and Final levels provide the students much required support in preparing for their exams conveniently at home as these classes can be accessed live or viewed later as recorded lectures through hand-held devices such as smart phones, laptops, I-pads, tablets, etc. anytime anywhere. Further,

students are advised to attempt the Multiple-Choice Questions (MCQs) at MCQ Paper Practice Portal which is a holistic platform for self-assessment within the stipulated timeframe.

Students are welcome to send their suggestions for fine tuning the RTP to the Joint Director, Board of Studies, The Institute of Chartered Accountants of India, A-29, Sector-62, Noida 201309 (Uttar Pradesh). RTP is also available on BOS Knowledge Portal at <https://boslive.icai.org> for downloading.

## II. Planning and preparing for examination

Ideally, when the RTP reaches your hand, you must have finished reading the relevant Study Materials of all the subjects. Get a good grasp of the concepts/ provisions/ amendments/ cases discussed therein.

After reading the Study Materials and Update thoroughly, then, proceed to solve the questions given in the RTP on your own. RTP is an effective tool to revise and refresh the concepts and provisions discussed in the Study Material. RTPs are provided to you to help you assess your level of preparation. Hence, you must solve the questions given therein on your own and thereafter compare your answers with the answers given therein.

### Examination tips

How well a student fares in the examination depends upon the level and depth of his preparation. However, there are certain important points which can help a student better his performance in the examination. These useful tips are given below:

- Reach the examination hall well in time.
- As soon as you get the question paper, read it carefully and thoroughly. You are given separate 15 minutes for reading the question paper.
- Plan your time so that appropriate time is awarded for each question.
- First impression is the last impression. The question which you can answer in the best manner should be attempted first.

- Always attempt to do all questions. Therefore, it is important that you must finish each question within allocated time. Keep sometime for checking the answers as well.
- Read the question carefully more than once before starting the answer to understand very clearly as to what is required.
- Answer all parts of a question one after the other; do not answer different parts of the same question at different places.
- Write in neat and legible hand-writing.
- Always be concise and write to the point and do not try to fill pages unnecessarily.
- There must be logical expression of the answer.
- In case a question is not clear, you may state your assumptions and then answer the question.
- Check your answers carefully and underline important points before leaving the examination hall.
- In case of case scenario based MCQs, read the facts given in the case attentively. Also, read each MCQ based thereon and all the options carefully, before choosing the correct answer.

### **III. Subject-wise Applicability**

#### **PAPER 1: FINANCIAL REPORTING**

For Paper 1 : Financial Reporting April, 2023 edition of the study material is applicable. The syllabus of Financial Reporting focuses on Ind AS integrated with Ethics and Technology. The Study Material has been divided into four modules for ease of handling by students.

For understanding the coverage of syllabus, it is important to read the Study Material along with the reference to Study Guidelines. It contains the detailed topic-wise exclusions from the syllabus. The Study Guidelines is given as part of "Applicability of Standards/Guidance Notes/Legislative Amendments etc. for May, 2024 – Final Examination" appended at the end of this Revision Test Paper.

You have to read the Study Material thoroughly to attain conceptual clarity. Tables, diagrams and flow charts have been extensively used to facilitate easy understanding of concepts. Examples and Illustrations given in the Study Material would help you understand the application of concepts. Thereafter, work out the questions at the end of each chapter to hone your problem-solving skills. Compare your answers with the answers given to test your level of understanding.

Thereafter, solve the questions given in this RTP independently and compare the same with the answers given to assess your level of preparedness for the examination. The Revisionary Test Paper (RTP) of Financial Reporting contains twenty questions and their answers.

Answers to the questions have been given in detail along with the working notes for easy understanding and comprehending the steps in solving the problems. The answers to the questions have been presented in the manner which is expected from the students in the examination. The students are expected to solve the questions under examination conditions and then compare their solutions with the solutions given in the Revisionary Test Paper and further strategize their preparation for scoring more marks in the examination.

### **PAPER 2: ADVANCED FINANCIAL MANAGEMENT**

Basically, the subject of Advanced Financial Management is to acquire the ability to apply financial management theories and techniques in strategic decision making. The major topics from which numerical questions are normally asked are as follows:

- Risk Management
- Advanced Capital Budgeting Decisions.
- Security Analysis & Valuation
- Portfolio Management
- Mutual Fund
- Derivatives
- Foreign Exchange Exposure and Risk Management

- International Financial Management
- Interest Rate Risk Management
- Business Valuation
- Mergers and Acquisitions

Accordingly, the detail of the topics, on which questions in this Revisionary Test Paper are based, is as follows:

Question No.	Topic
1	Case Scenario (Securitization)
2	Case Scenario (Security Analysis)
3	Derivatives Analysis & Valuation
4	Derivatives Analysis & Valuation
5	Business Valuation
6	Foreign Exchange Exposure and Risk Management
7	Foreign Exchange Exposure and Risk Management
8	Advanced Capital Budgeting Decisions
9	Interest Rate Risk Management
10	Mutual Fund
11	Portfolio Management
12	Security Valuation
13	International Financial Management
14	A theoretical Question
15	A theoretical Question

### **PAPER 3: ADVANCED AUDITING, ASSURANCE AND PROFESSIONAL ETHICS**

RTP is a tool to refresh your knowledge which you have acquired while doing conceptual study from Study Material and other modes of knowledge like student journal, saransh, bare acts etc.



This RTP of Advanced Auditing, Assurance and Professional Ethics is relevant for May 2024 Examination. Total 20 Questions consisting of case scenario based multiple choice questions, independent multiple choice questions and descriptive questions have been taken from the entire syllabus divided into Nineteen chapters.

These 20 questions are taken from different topics like Quality Control, General Auditing Principles and Auditor's Responsibilities, Materiality, Risk Assessment and Internal Control, Reporting, Related Services, Prospective Financial Information and Other Assurance Services, Digital Auditing and Assurance, Group Audits, Special Features of Audit of Banks & Non-Banking Financial Companies, Audit of Public Sector Undertakings, Internal Audit, Sustainable Development Goals (SDG) & Environment, Social and Governance (ESG) Assurance and Professional Ethics and Liabilities of Auditors etc. of different level. Some of the questions given in the RTP are descriptive i.e. direct theory questions (Knowledge and Comprehension) based whereas some of them are practical case studies based i.e. application-oriented theory question (Application and Analysis / Evaluation and Synthesis). The name of the chapter is clearly indicated before each question.

Examples and illustrations given in the Study Material would help you understand the application of concepts. Work out the exercise questions at the end of each chapter and then, compare your answers with the answers given to test your level of understanding. Thereafter, solve the MCQs and case scenarios based MCQs uploaded in MCQ Paper Practice Dashboard to assess your level of understanding and hone your analytical and problem-solving skills.

Finally, solve the questions given in this RTP independently and compare the same with the answers given to assess your level of preparedness for the examination.





## PAPER – 1: FINANCIAL REPORTING



### QUESTIONS

#### Case Scenario - I

FA Ltd. is a company which manufactures aircraft parts and engines and sells them to large multinational companies like Boeing and Airbus Industries. Following are the details of some of the transactions entered into by the company:

- i. On 1<sup>st</sup> April 20X2, the company began the construction of a new production line in its aircraft parts manufacturing shed.

Costs relating to the production line are as follows:

Details	Amount ₹ in lakhs
Costs of the basic materials (list price ₹ 12.5 lakhs less 20% trade discount)	10.00
Recoverable goods and services tax incurred but not included in the purchase cost	1.00
Employment costs of the construction staff for three months till 30 <sup>th</sup> June 20X2	1.20
Other overheads directly related to the construction	0.90
Payments to external advisors relating to the construction	0.50
Expected dismantling and restoration costs	2.00

The production line took two months to make ready for use and was brought into use on 31<sup>st</sup> May 20X2.

The other overheads were incurred during the two-month period ended on 31<sup>st</sup> May 20X2. They included an abnormal cost of ₹ 0.3 lakhs caused by a major electrical fault.

The production line is expected to have a useful economic life of eight years. After 8 years, FA Ltd. is legally required to dismantle the plant in a specified manner and restore its location to an acceptable standard. The amount of ₹ 2 lakhs included in the cost estimates is the amount that is expected to be incurred at the end of the useful life of the production line. The appropriate discount rate is 5%. The present value of ₹ 1 payable in 8 years at a discount rate of 5% is approximately ₹ 0.68.

Four years after being brought into use, the production line will require a major overhaul to ensure that it generates economic benefits for the second half of its useful life. The estimated cost of the overhaul, at current prices, is ₹ 3 lakhs.

No impairment of the plant had occurred by 31<sup>st</sup> March 20X3.

- ii. During the year ended 31<sup>st</sup> March 20X3, FA Ltd. provided consultancy services to a customer regarding the installation of a new production system related to aircraft parts. The system has caused the customer considerable problems, so the customer has taken legal action against the Company for the loss of profits that has arisen as a result of the problems with the system. The customer has claimed damages to the tune of ₹ 1.6 lakhs.

The legal department of FA Ltd. considers that there is a 25% chance the claim can be successfully defended. The legal department further stated that they are reasonably confident the Company is covered by insurance against these types of loss. The accountant feels nothing needs to be provided for this claim as the Company is suitably covered against any possible losses.

- iii. FA Ltd. has an associate company, Flynet Limited. Following are the information of Flynet Limited for the year ended 31<sup>st</sup> March 20X3:

Particulars	₹ in lakhs
Net Income after taxes	120
Decrease in accounts receivables	20
Depreciation	25
Increase in inventory	10
Increase in accounts payable	7
Decrease in wages payable	5
Tax charge for the year (deferred tax liabilities)	15
Profit from sale of land	2

***On the basis of the facts given above, chose the most appropriate answer to Questions 1 to 5 below based on the relevant Indian Accounting Standards (Ind AS).***

- Which of the following items need to be capitalized in determining the cost of Production Line?
  - Abnormal cost of ₹ 0.3 lakhs
  - Recoverable GST of ₹ 1 lakhs
  - Initial estimate of the costs of dismantling and removing the item and restoration of site of ₹ 2 lakhs
  - Initial estimate of the costs of dismantling and removing the item and restoration of site of ₹ 1.36 lakhs
- Calculate the company's associate Flynet Ltd.'s cash flow from operations.
  - ₹ 158 lakhs
  - ₹ 170 lakhs
  - ₹ 174 lakhs
  - None of the above

3. What accounting treatment should be done in FA Ltd.'s books for the year ending 31<sup>st</sup> March 20X3, as the customer has taken legal action against the Company on the loss of profits that has arisen as a result of the problems with the system?
- (a) Nothing needs to be provided for claim instituted by the customer as the Company is suitably covered against any possible losses.
  - (b) Provision of ₹ 1.6 lakhs should be recognised with a corresponding charge to profit or loss.
  - (c) Provision of ₹ 0.4 lakhs as per best possible outcome should be recognised with a corresponding charge to profit or loss.
  - (d) Contingent Liability would be disclosed in the 31<sup>st</sup> March 20X3 financial statements. Charge to profit or loss if any would be recognised in the period when the claim is settled.
4. Compute the total amount to be charged to the Statement of Profit and Loss with respect to Production Line for the year ending 31<sup>st</sup> March 20X3 and the balance of Provision for Dismantling Cost carried to Balance Sheet.
- (a) ₹ 1.70 lakhs; ₹ 1.36 lakhs
  - (b) ₹ 1.42 lakhs; ₹ 1.70 lakhs
  - (c) ₹ 1.76 lakhs; ₹ 1.42 lakhs
  - (d) ₹ 1.42 lakhs; ₹ 1.76 lakhs
5. Compute the cost of the production Line to be capitalized initially on 31<sup>st</sup> May, 20X2.
- (a) ₹ 13.26 lakhs
  - (b) ₹ 14.60 lakhs
  - (c) ₹ 13.96 lakhs
  - (d) ₹ 15.76 lakhs

**Case Scenario - II**

HS Limited (HSL) is a car manufacturing company. During the year, HSL has entered into many transactions, details of which are given below.

- i. With the intention to expand, HSL has entered into a Share Purchase Agreement ("SPA") with the shareholders of FM Limited to purchase 30% stake in FM Limited as at 1<sup>st</sup> June 20X2 at a price of ₹ 30 per share. As per the terms of SPA, HSL has an option to purchase an additional 25% stake in FM Limited on or before 15<sup>th</sup> June 20X2 at a price of ₹ 30 per share. Similarly, the selling shareholder has an option to sell additional 25% stake in FM Limited on or before 15<sup>th</sup> June, 20X2 to HSL at a price of ₹ 30 per share. The decisions on relevant activities of FM Limited are made in Annual General Meeting / Extraordinary General Meeting (AGM / EGM). A resolution in AGM / EGM is passed when more than 50% votes are cast in favour of the resolution. An AGM / EGM can be called by giving atleast 21 days advance notice to all shareholders.
- ii. During the year, HSL issued Compulsory Convertible Debentures ("CCDs") on a private placement basis for ₹ 100 lakh. Each CCD is convertible into 5 shares at the end of 4 years from the date of issue and an annual interest is payable at the rate of 6% p.a. At initial recognition, HSL recognized a liability component of compound instrument at ₹ 20,79,063. HSL also incurred expenses of ₹ 2,00,000 in connection with the issue of the instrument. Nature of expenses includes fees paid to legal advisors, registration and regulatory fees.
- iii. HSL acquired a 40% stake in NM Limited as at 1<sup>st</sup> January, 20X2 for ₹ 8,00,000 and classified the investment in NM Limited as an associate. As at 1<sup>st</sup> January, 20X2, the carrying amount and fair value of plant & equipment of NM Limited is ₹ 3,00,000 and ₹ 5,00,000 respectively with remaining useful life of 5 years (i.e. 20 quarters). From 1<sup>st</sup> January, 20X2 to 31<sup>st</sup> March, 20X2, NM Limited generated a profit of ₹ 50,000.
- iv. While selling a car, HSL provides a trade discount of 1% on the sale price which is mentioned on the invoice. HSL provides a credit period of 7 days to its customers, however if paid upfront then HSL gives an

additional cash discount of 2%. HSL also provides a voucher worth ₹ 500 with a validity of 1 year which can be used at an apparel store.

***On the basis of the facts given above, chose the most appropriate answer to Questions 6 to 10 below based on the relevant Indian Accounting Standards (Ind AS).***

6. At what amount HSL shall carry its investments in NM Limited in its consolidated financial statements as at 31<sup>st</sup> March, 20X2?
  - (a) ₹ 8,00,000
  - (b) ₹ 8,20,000
  - (c) ₹ 8,16,000
  - (d) ₹ 8,10,000
7. How should HSL account for the trade discount, cash discount and voucher given to customers on sale of a car?
  - (a) Trade discount shall be reduced from the revenue however cash discount and value of voucher shall be charged as expenses.
  - (b) Trade discount and cash discount both shall be reduced from the revenue however value of voucher shall be charged as expenses.
  - (c) Trade discount, cash discount and value of voucher shall be charged as expenses.
  - (d) Trade discount, cash discount and value of voucher shall be reduced from revenue.
8. What shall be the accounting treatment of directly attributable expenses of ₹ 2 lakh incurred in connection with the issue of Compulsory Convertible Debentures?
  - (a) Entire ₹ 2,00,000 shall be recognized as expenses in the statement of profit and loss in the current year.
  - (b) Entire ₹ 2,00,000 shall be reduced from equity in the current year.
  - (c) A proportion of ₹ 1,58,419 shall be reduced from equity and Balance of ₹ 41,581 shall be recognized as interest cost over the period of 4 years using an effective interest method.



- (d) Entire ₹ 2,00,000 shall be recognized as interest cost over the period of 4 years using effective interest method.
9. With more acquisitions, at the end of the year, HSL has investments in 2 subsidiaries, 3 associates and 1 joint venture. Which of the following statements is correct in relation to accounting of these investments in separate financial statements?
- (a) HSL is required to measure all such investments at cost.
- (b) HSL has an option to account for the investments in associates and joint ventures using the equity method of accounting and carry the investments in subsidiaries at cost.
- (c) HSL has an option for each investment to measure either at cost or in accordance with Ind AS 109.
- (d) HSL has an option to measure all such investments either at cost or in accordance with Ind AS 109. The option is available for each category of investments separately (i.e. subsidiaries, associates and joint venture).
10. With respect to the SPA entered by HSL, determine the date when HSL gained control over FM Limited
- (a) 1<sup>st</sup> June, 20X2.
- (b) 15<sup>th</sup> June, 20X2.
- (c) On the date of AGM/EGM
- (d) On the date when the resolution for AGM/EGM is issued.

**Ind AS 103 'Business Combinations'**

11. On 1<sup>st</sup> April 20X1, Pride Limited acquired 30% of the ordinary shares of Famous Limited for ₹ 4,000 crores. Pride Limited accounts for its investment in Famous Limited using the equity method as prescribed under Ind AS 28. On 31<sup>st</sup> March 20X2, Pride Limited recognized its share of the net asset changes of Famous Limited using equity method accounting as follows:

Share of profit	₹ 350 crore
Share of exchange difference in OCI	₹ 50 crore
Share of revaluation reserve of PPE in OCI	₹ 25 crore

The carrying amount of the investment in the associate on 31<sup>st</sup> March 20X2 is therefore ₹ 4,425 crore (4,000 + 350 + 50 + 25).

On 1<sup>st</sup> April 20X2, Pride Limited acquired the remaining 70% of Famous Limited for cash ₹ 12,500 crore.

The following additional information is relevant at that date:

Fair Value of 30% interest in Famous Limited as on 1 <sup>st</sup> April 20X2	₹ 4,500 crore
Fair Value of Net Identifiable Assets of Famous Limited as on 1 <sup>st</sup> April 20X2	₹ 15,000 crore

You are required to

- (i) Determine the acquisition date for Pride Ltd.
- (ii) Determine the gain on previously held interest in Pride Ltd. and suggest the accounting treatment on acquisition date as per Ind AS 103.
- (iii) Compute the amount of goodwill arising on the acquisition of Famous Ltd.
- (iv) Pass necessary journal entry on the acquisition date.

#### Professional and Ethical Duty of a Chartered Accountant

12. Astra Ltd. is a listed entity which operates in the defence and fibre optics sector. It supplies fibre optic cables and racks in the domestic country. This activity is only a trading activity for Astra Ltd. as it procures goods from pre-approved suppliers, and after inspection, sells the goods to IT companies. The sale contract requires Astra Ltd. to deliver these goods to the IT companies' locations (i.e., delivery on site). Payment terms are 30 days after the invoice date to Astra Ltd.

Ms. Suparna Dasgupta, a chartered accountant, has recently joined Astra Ltd. as the Head of the Finance Department.

The Chief Operating Officer (also the executive director) of Astra Ltd. is Ms. Padmaja Srinivasan, a mechanical engineer with an MBA from Harvard University, who rose through the ranks through her excellent skills in project management, marketing, and customer management. Her remuneration includes a bonus computed as a percentage of turnover achieved during the year, and an additional incentive for achieving an EBITDA in excess of 15% of turnover.

Astra Ltd. has sold fibre optic cables amounting to ₹ 2 crores (invoice dated 31<sup>st</sup> March 20X2) to Ethernet Bullet Ltd., a company providing high-speed internet connectivity services through fibre optic cables as well as dedicated leased lines. The service unit of Ethernet Bullet Ltd. is located next to the factory of Astra Ltd. Though the goods were not moved to Ethernet Bullet Ltd.'s service unit, Astra Ltd. recognized the sale for the year, based on the contention that the service unit is adjacent, and hence the transfer can happen within a few minutes.

The annual results are due for board approval, for the year ending 31<sup>st</sup> March, and require the sign-off of Ms. Suparna Dasgupta.

Ms. Suparna Dasgupta has been given a 40% increment on joining Astra Ltd., which enables her to comfortably pay off her housing loan mortgage every month. Additionally, she is also given perquisites in the form of business class travel, an exclusive chauffeur-driven car and stock options of the company. Accordingly, she has stated that she cannot afford to lose this job as the salary and perquisites are among the best in the country.

Ms. Padmaja Srinivasan has communicated to Ms. Suparna Dasgupta that many more benefits will accrue if she agrees to present the numbers without any modifications. She has also said that the company would not hesitate to replace Ms. Suparna Dasgupta should she disagree with the contentions above.

**Required:**

Discuss the potential conflicts which are arising in the above scenario and the ethical principles that would guide Ms. Suparna Dasgupta in responding to the situation.

**Ind AS 22 'Income Taxes'**

13. Joy Ltd. wishes to calculate tax base of its assets and liabilities as on 31<sup>st</sup> March 20X5. The Balance Sheet has been adjusted by current tax expense.

Summarised Balance Sheet as on 31<sup>st</sup> March 20X5:

<b>ASSETS</b>	<b>₹</b>
<b>Non-current Assets</b>	
Property, Plant and Equipment	12,00,000
Intangible Assets-Product Development Costs	60,000
Investment in Subsidiary - Pall Ltd.	4,40,000
<b>Current Assets</b>	
Trade Investments	2,08,000
Trade Receivables	6,26,000
Inventories	3,04,000
Cash and Cash Equivalents	<u>1,80,000</u>
<b>TOTAL ASSETS</b>	<b><u>30,18,000</u></b>
<b>EQUITY &amp; LIABILITIES</b>	<b>₹</b>
<b>Equity</b>	
Share Capital	12,00,000
Accumulated Profits	7,37,438
Revaluation Surplus	88,000
<b>Non-current Liabilities</b>	
Deferred Income - Government Grants	40,000
Liability for Product Warranty Costs	16,000

Deferred Tax Liability (From 20X3-20X4)	22,162
<b>Current Liabilities</b>	
Trade Payables	7,64,000
Health Care Benefits for Employees	70,000
Current Tax Liability	<u>80,400</u>
<b>TOTAL EQUITY &amp; LIABILITIES</b>	<b><u>30,18,000</u></b>

**Notes:**

- (a) Depreciation expense for the year 20X4-20X5 allowable in accordance with tax laws is ₹ 2,06,000. Accounting depreciation included in operating costs is ₹ 1,70,000. Cost of PPE is ₹ 16,00,000 and Joy Ltd has deducted expenses of ₹ 4,16,000 in its tax returns prior to the financial year 20X4-20X5. Moreover, as on 31<sup>st</sup> March 20X5, Joy Ltd for the first time revalued its property, plant and equipment to fair value of ₹ 12,00,000 (revaluation surplus = ₹ 88,000).
- (b) In 20X1-20X2, Joy Ltd incurred product development costs of ₹ 1,00,000. These costs were recognized as an asset and being amortized over useful period of 10 years. For tax purposes, Joy Ltd deducted full product development costs in 20X1-20X2.
- (c) Trading investments were acquired in 20X3-20X4 with cost of ₹ 2,30,000. These investments are classified at fair value through profit and loss and thus recognized at their fair value. Fair value adjustments are not tax deductible.
- (d) Bad debt provision amounts to ₹ 1,30,000 and relates to 2 debtors:
- Debtor A - ₹ 80,000 (receivable originated in 20X2-20X3 and 100% provision was recognized in 20X3-20X4) and
  - Debtor B - ₹ 50,000 (receivable originated in 20X3-20X4 and 100% provision was recognized in 20X4-20X5).

Tax law allows deduction of 20% of provision for debtors overdue for more than 1 year, another 30% for debtors overdue for more

than 2 years and remaining 50% for debtors overdue for more than 3 years.

- (e) Joy Ltd accounts for inventory obsolescence provision. New provision created in 20X4-20X5 was ₹ 10,800 (total provision: ₹ 18,000). This provision is not tax deductible, as it is a general provision.
- (f) Government grants are not taxable. Government grant received in 20X4-20X5 is appearing in the balance sheet.
- (g) In 20X4-20X5, Joy Ltd made a further provision for product warranty of ₹ 5,000. Such provisions for product warranty costs are not tax deductible until the claims are paid or settled. During the year 20X4-20X5, warranty claims were paid/settled for ₹ 6,200.
- (h) During the year 20X4-20X5, Joy Ltd introduced health care benefits for employees. The expenses are allowable as a deduction in tax only when benefits are paid but in line with Ind AS 19, such liability is recognized in profit or loss when employees provide service.

Calculate temporary differences and deferred tax for Joy Ltd as on 31<sup>st</sup> March 20X5 assuming the tax rate is 32%.

#### Ind AS 23 'Borrowing Costs'

14. PQR Limited is engaged in Tourism business in India. The company has planned to construct a Holiday Resort (Qualifying Asset) at Shimla. The cost of the project has been met out of borrowed funds of ₹ 100 lakhs at the rate of 12% p.a. ₹ 40 lakhs were disbursed on 1<sup>st</sup> April 20X2 and the balance of ₹ 60 lakhs were disbursed on 1<sup>st</sup> June 20X2. The site planning work commenced on 1<sup>st</sup> June 20X2, since the Chief engineer of the project was on medical leave. The company commenced physical construction on 1<sup>st</sup> July 20X2 and the work of construction continued till 30<sup>th</sup> September 20X2 and thereafter the construction activities stopped due to landslide on the road which leads to construction site. The road blockages have been cleared by the government machinery by 31<sup>st</sup> December 20X2. Construction

activities resumed on 1<sup>st</sup> January 20X3 and has completed on 28<sup>th</sup> February 20X3.

The date of opening has been scheduled for 1<sup>st</sup> March 20X3, but unfortunately, the District Administration gave permission for opening on 16<sup>th</sup> March 20X3, due to lack of safety measures like fire extinguishers which had not been installed by then.

Determine the amount of borrowing cost to be capitalized towards construction of the resort when

- (i) Landslide is not common in Shimla and delay in approval from District Administration Office is minor administrative work leftover.
- (ii) Landslide is common in Shimla and delay in approval from District Administration Office is major administrative work leftover.

**Ind AS 10 'Events Occurring After the Balance Sheet Date' and Ind AS 109 'Financial Instruments'**

15. The company has made sales of ₹ 60,00,000 to a customer SS LLP on 31<sup>st</sup> December 20X2. The normal credit is for one month. However, sometimes, it goes upto 2 months. The company expects to receive payment by 28<sup>th</sup> February 20X3. However, no payment has been received till 31<sup>st</sup> March 20X3. On 15<sup>th</sup> April 20X3, the sales department of the company became aware that the customer is passing through financial crisis and has major cash flow problems.

The company has agreed to allow the customer to settle the debt by 31<sup>st</sup> March 20X4, by which time the customer is confident that the cashflow problem will be resolved.

The company expects that an annual interest of 9% (i.e. effective interest rate) can be received against any money lent out, yet it allowed the customer an interest-free payment period.

Determine the amount to be shown as 'trade receivable' from SS LLP in the books of the company as on 31<sup>st</sup> March 20X3.

**Ind AS 2 'Inventories'**

16. B Limited has valued its stock held for distribution as free items on claim by customers (on offers) at zero. The customers have a right to claim the free item within 14 days from the date of invoice. If the time limit of 14-day exceeds, the claim is foregone by the customer.

The majority of the free items require online registration by the buyers for participation in the contest conducted by the respective brand which needs to be done by the buyers within 3 days from the date of invoice.

Out of it, a few items under this category were found damaged. The replacement cost of such items would be ₹ 2,50,000.

Determine whether the entity has to book loss of inventory or provide for replacement cost of the goods that need to be given as free items to customers as per the principles of Ind AS.

**Ind AS 7 'Statement of Cashflows'**

17. Following is the Balance Sheet of Mars Ltd: ₹ in Lakhs

Particulars	31.3.20X3	31.3.20X2
<b>ASSETS</b>		
<b>Non-Current Assets</b>		
Property, Plant and Equipment	450	410
Intangible asset	90	90
Deferred Tax Asset (net)	45	45
Other Non-current Asset	<u>95</u>	<u>85</u>
Total Non-current Assets	<u>680</u>	<u>630</u>
<b>Current Assets</b>		
Financial Asset		
Investments	100	60
Trade Receivables	580	600



Cash and Cash Equivalents	300	300
Inventories	800	700
Other Current Assets	<u>160</u>	<u>120</u>
Total Current Assets	<u>1,940</u>	<u>1,780</u>
<b>Total Assets</b>	<b><u>2,620</u></b>	<b><u>2,410</u></b>
<b>Equity and Liabilities</b>		
<b>Equity</b>		
Equity Share Capital	280	250
Other Equity	<u>980</u>	<u>820</u>
Total Equity	<u>1,260</u>	<u>1,070</u>
<b>Non-current Liabilities</b>		
Financial Liabilities		
Borrowings	360	300
Other Non-current Liabilities	<u>90</u>	<u>80</u>
Total Non-current Liabilities	<u>450</u>	<u>380</u>
<b>Current Liabilities</b>		
Financial Liabilities		
Trade Payable	455	450
Bank Overdraft	410	420
Other current liabilities	<u>45</u>	<u>90</u>
Total Current Liabilities	<u>910</u>	<u>960</u>
Total Liabilities	<u>1,360</u>	<u>1,340</u>
<b>Total Equity and Liabilities</b>	<b><u>2,620</u></b>	<b><u>2,410</u></b>

Additional Information:

- (a) Profit before tax for the year is ₹ 200 lakhs and provision for tax is ₹ 40 lakhs.
- (b) Property, Plant and Equipment purchased during the year ₹ 100 lakhs.
- (c) Current liabilities include Capital creditors of ₹ 25 lakhs as at 31<sup>st</sup> March 20X3 (Nil – 31<sup>st</sup> March 20X2)
- (d) Long Term Borrowings raised during the year ₹ 120 lakhs.

From the information given, prepare a Statement of Cash Flows following the Indirect Method. Assume that Bank overdraft is an integral part of the entity's cash management.

**Ind AS 115 'Revenue from Contracts with Customers'**

18. A property sale contract includes the following:

- (a) Common areas
- (b) Construction services and building material
- (c) Property management services
- (d) Golf membership
- (e) Car park
- (f) Land entitlement

Whether they could be considered as separate performance obligations as per the requirements of Ind AS 115?

**Ind AS 110 'Consolidated Financial Statements'**

19. At the beginning of its current financial year, AB Limited holds 90% equity interest in BC Limited.

During the financial year, AB Limited sells 70% of its equity interest in BC Limited to PQR Limited for a total consideration of ₹ 56 crore and consequently loses control of BC Limited.

At the date of disposal, fair value of the 20% interest retained by AB Limited is ₹ 16 crore and the net assets of BC Limited are fair valued at ₹ 60 crore.

These net assets include the following:

- (a) Debt investments classified as fair value through other comprehensive income (FVOCI) of ₹ 12 crore and related FVOCI reserve of ₹ 6 crore.
- (b) Net defined benefit liability of ₹ 6 crore that has resulted in a reserve relating to net measurement losses of ₹ 3 crore.
- (c) Equity investments (considered not held for trading) of ₹ 10 crore for which irrevocable option of recognising the changes in fair value in FVOCI has been availed and related FVOCI reserve of ₹ 4 crore.
- (d) Net assets of a foreign operation of ₹ 20 crore and related foreign currency translation reserve of ₹ 8 crore.

In consolidated financial statements of AB Limited, 90% of the above reserves were included in equivalent equity reserve balances, with the 10% attributable to the non-controlling interest included as part of the carrying amount of the non-controlling interest.

What would be the accounting treatment on loss of control in the consolidated financial statements of AB Limited?

**Ind AS 102 'Share-Based Payments'**

20. Fashion India Ltd. (FIL) entered into an agreement with RFD Ltd. on 10<sup>th</sup> August, 20X2 for purchasing a machinery. The agreement has a clause that FIL will have to settle the consideration of machinery purchased by issuing its equity shares. FIL agreed to the clause and the order was confirmed. Machinery was supplied vide invoice dated 25<sup>th</sup> October, 20X2 and delivered on 1<sup>st</sup> November, 20X2. The agreed purchase consideration was ₹ 150 Lakhs and the fair value of the machinery supplied was estimated to be ₹ 160 Lakhs. As agreed, FIL issued 1,00,000 equity shares of face value ₹ 100 each to RFD Ltd.

As per Ind AS 102 'Share Based Payment', what should be the price and the date for recording the machinery purchased from RFD Ltd.?



## SUGGESTED ANSWERS/HINTS

### Answer to Case Scenario I

- Option (d):** Initial estimate of the costs of dismantling and removing the item and restoration of site of ₹ 1.36 lakhs

**Reason:**

As per para 16(c) of Ind AS 16, elements of cost of PPE includes the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

- Option (b):** ₹ 170 lakhs

**Reason:**

**Cash flow from operating activities – Indirect method**

Particulars	₹ in lakhs
Net Income after taxes	120
Add /(Less) No- cash or non-operating item:	
Depreciation	25
Profit from sale of land	(2)
Tax charges for the year (deferred tax liabilities)	<u>15</u>
	158
Decrease in accounts receivables	20
Increase in inventory	(10)
Increase in accounts payable	7
Decrease in wages payable	<u>(5)</u>
Cash flow from operations	<u>170</u>

3. **Option (b):** Provision of ₹ 1.6 lakhs should be recognized with a corresponding charge to profit or loss.

**Reason:**

In accordance with Ind AS 37 '*Provisions, Contingent Liabilities and Contingent Assets*', the claim made by the customer needs to be recognised as a liability in the financial statements for the year ended 31<sup>st</sup> March 20X3.

The standard stipulates that a provision should be made when, at the reporting date:

- An entity has a present obligation arising out of a past event.
- There is a probable outflow of economic benefits.
- A reliable estimate can be made of the outflow.

Since all three of the above conditions are satisfied here, a provision is required to be made.

The provision should be measured at the amount the entity would rationally pay to settle the obligation at the reporting date.

Where there is a range of possible outcomes, the individual most likely outcome is often the most appropriate measure to use.

In this case, a provision of ₹ 1.6 lakhs seem appropriate, with a corresponding charge to profit or loss.

4. **Option (c):** ₹ 1.76 lakhs; ₹ 1.42 lakhs

5. **Option (a):** ₹ 13.26 lakhs

**Reason for 4 & 5:****Statement showing computation of cost of production line**

Particulars	₹ in lakhs
Purchase cost	10.00
GST – recoverable goods and services tax not included	-
Employment costs during the period of getting the production line ready for use [(1.2/3 month) x 2 month]	0.80

Other overheads – abnormal costs of ₹ 0.3 lakhs have been excluded (0.90- 0.30)	0.60
Payment to external advisors – directly attributable cost	0.50
Dismantling costs – recognized at present value (2 lakhs x 0.68)	<u>1.36</u>
Total	<u>13.26</u>

**Provision for dismantling cost carried to Balance Sheet**

Particulars	₹ in lakhs
Non-current liabilities (₹ 2 lakhs x 0.68)	1.36
Add: Finance cost (1.36 x 5% x 10/12)	<u>0.06</u>
Net book value – carried to Balance Sheet	<u>1.42</u>

**Extract of Statement of Profit and Loss**

Particulars	₹ in lakhs
Depreciation (W.N.)	1.70
Finance cost (1.36 x 5% x 10/12)	<u>0.06</u>
Amounts carried to Statement of Profit & Loss	<u>1.76</u>

**Working Note:****Calculation of depreciation charge**

Particulars	₹ in lakhs
The asset is split into two depreciable components out of the total capitalization amount of 13.26 lakhs:	
<ul style="list-style-type: none"> <li>Depreciation for ₹ 3 lakhs with a useful economic life of four years (3 lakhs x <math>\frac{1}{4}</math> x 10/12).</li> </ul> (This is related to a major overhaul to ensure that it generates economic benefits for the second half of its useful life)	0.63

<ul style="list-style-type: none"> <li>Depreciation for ₹ 10.26 lakhs (13.26 – 3.00) with a useful economic life of eight years will be: ₹ 10.26 lakhs x 1/8 x 10/12</li> </ul>	<u>1.07</u>
Total depreciation to be charged to Statement of Profit and Loss for the year ended 31 <sup>st</sup> March 20X3	<u>1.70</u>

**Answer to Case Scenario II****6. Option (c): ₹ 8,16,000****Reason:**

As per para 10 of Ind AS 28, under the equity method, on initial recognition the investment in an associate or a joint venture is recognised at cost, and the carrying amount is increased or decreased to recognise the investor's share of the profit or loss of the investee after the date of acquisition.

Accordingly,

Cost of investment for 40% stake on acquisition date	₹ 8,00,000
Add: Share of post-acquisition profit and loss (50,000 x 40%)	₹ 20,000
Less: Share of post-acquisition loss due to additional depreciation [(5,00,000 – 3,00,000)/20} x 40%]	<u>(₹ 4,000)</u>
	<u>₹ 8,16,000</u>

**7. Option (d): Trade discount, cash discount and value of voucher shall be reduced from revenue****Reason**

Discounts and vouchers are incentives given to customers. For Incentives, Paragraph 70 of Ind AS 115, inter-alia, states that consideration payable to a customer includes cash amounts that an entity pays, or expects to pay, to the customer (or to other parties that purchase the entity's goods or services from the customer). Consideration payable to a customer also includes credit or other items (for example, a coupon or voucher) that can be applied against amounts owed to the entity (or to other parties that purchase the

entity's goods or services from the customer). An entity shall account for consideration payable to a customer as a reduction of the transaction price and, therefore, of revenue.

Therefore, cash incentives (payments given to the customer) would be considered as a reduction in the transaction price and in the measurement of revenue when the goods are delivered.

8. **Option (c):** A proportion of ₹ 1,58,419 shall be reduced from equity and balance of ₹ 41,581 shall be recognised as interest cover over the period of 4 years using effective interest method

**Reason**

Compulsory convertible debentures with annual interest payout is a compound financial instrument. As per the information given in the question the liability element to be initially recognised is ₹ 20,79,063. Hence the equity element would be ₹ 79,20,937 (1,00,00,000 – 20,79,063). Transaction cost of ₹ 2,00,000 will be apportioned in equity and liability component in the ratio of 79,20,937 : 20,79,063, which would be as follows:

Transaction cost attributable to equity =  $2,00,000 \times (79,20,937 / 1,00,00,000) = ₹ 1,58,419$

Transaction cost attributable to liability =  $2,00,000 \times (20,79,063 / 1,00,00,000) = ₹ 41,581$

9. **Option (d):** HSL has an option to measure all such investments either at cost or in accordance with Ind AS 109. The option is available for each category of investments separately (i.e. subsidiaries, associates, and joint venture)

**Reason**

As per para 10 of Ind AS 27, when an entity prepares separate financial statements, it shall account for investments in subsidiaries, joint ventures and associates either: (a) at cost, or (b) in accordance with Ind AS 109. The entity shall apply the same accounting for each category of investments.



In the present case, investment in subsidiaries, associates and joint ventures are considered to be different categories of investments. Further, Ind AS 27 requires accounting for the investment in subsidiaries, joint ventures and associates either at cost, or in accordance with Ind AS 109 for each category of Investment. Thus, an entity can carry its investments in subsidiaries at cost and its investments in associates or joint ventures as financial assets in accordance with Ind AS 109 in its separate financial statements.

**10. Option (a): 1<sup>st</sup> June, 20X2**

**Reason**

Paragraph 10 of Ind AS 110 'Consolidated Financial Statements', states that an investor has power over an investee when the investor has existing rights that give it the current ability to direct the relevant activities, i.e. the activities that significantly affect the investee's returns.

As per the facts given in the question, HSL has 15 days to exercise the option to purchase 25% additional stake in FM Ltd., which will give it majority voting rights of 55% (30% + 25%). This is a substantive potential voting rights which is currently exercisable.

Further, the decisions on relevant activities of FM Ltd. are made in AGM / EGM. An AGM / EGM can be called by giving at least 21 days advance notice. A resolution in AGM / EGM is passed when more than 50% votes are cast in favour of the resolution. Thus, the existing shareholders of FM Ltd. are unable to change the existing policies over the relevant activities before the exercise of option by HSL. HSL can exercise the option and get voting rights more than 50% at the date of AGM / EGM. Accordingly, the option contract gives HSL the current ability to direct the relevant activities even before the option contract is settled. Therefore, HSL controls FM Ltd. as at 1<sup>st</sup> June, 20X2.

**11. (i) Acquisition date for accounting of business combination is**

The date on which the acquirer obtains control of the acquiree is generally the date on which the acquirer legally transfers the consideration, acquires the assets and assumes the liabilities of the acquiree. In the given case, the acquisition date is

1<sup>st</sup> April, 20X2 i.e. when Pride Ltd. acquired 100% holding of Famous Ltd.

**(ii) Computation of gain on previously held interest**

An entity shall discontinue the use of the equity method from the date when its investment ceases to be an associate or a joint venture. If the investment in an associate becomes a investment in a subsidiary, the entity shall account for its investment in accordance with Ind AS 103 and Ind AS 110.

Ind AS 103 provides that in a business combination achieved in stages, the acquirer is required to remeasure the previously held equity interest at its acquisition date fair value and recognise any gain or loss in profit or loss or other comprehensive income, as appropriate. In prior reporting periods, the acquirer may have recognised changes in the value of its equity interest in the acquiree in other comprehensive income. If so, the amount that was recognised in the other comprehensive income shall be recognised on the same basis as would be required if the acquirer had disposed directly of the previously held equity interest.

The gain on previously held equity interest in Famous Ltd. is calculated as follows:

Fair value of 30% interest as on 1 <sup>st</sup> April, 20X2	₹ 4,500 crore
Carrying value of 30% investment as on 31 <sup>st</sup> March, 20X2	(₹ 4,425 crore)
Gain on previously held interest	₹ 75 crore
Unrealised gain previously recognised in OCI	₹ 50 crore
Total gain recognised in Profit and loss	₹ 125 crore

**(iii) Computation of goodwill**

For 70% share	₹ 12,500 crore
For 30% share	₹ 4,500 crore
Total amount of purchase consideration	₹ 17,000 crore

Less: Fair value of net identifiable assets	(₹ 15,000 crore)
Goodwill	₹ 2,000 crore

**(iv) Journal Entry on 1<sup>st</sup> April, 20X2**

		₹ in crore	
Net Identifiable Assets	Dr.	15,000	
Goodwill (W.N.1)	Dr.	2,000	
Foreign currency translation reserve	Dr.	50	
PPE revaluation reserve	Dr.	25	
To Cash			12,500
To Investment in Associate – Famous Ltd.			4,425
To Retained Earnings (W.N.)			25
To Gain on previously held interest recognised in profit and loss (Refer point (ii) above)			125

**Working Note:**

The credit to retained earnings represents the reversal of the unrealised gain of ₹ 25 crore in OCI related to the revaluation of PPE. In accordance with Ind AS 16, this amount is not reclassified to profit or loss.

**12. Presentation of Revenue numbers:**

Ind AS 115 'Revenue from Contracts with Customers' requires revenue to be recognized only on satisfaction of the performance obligations under the contract. It is crucial that the performance obligations be identified at the commencement of the contract, so that the trigger points for revenue recognition become identifiable.

Management would always have an incentive to present higher revenue numbers. In the given case, the fact that the COO is given an incentive for revenues and EBITDA indicates that revenue is a potential area for material misstatement, given the personal interest of the COO in the same.

The sale of fibre optic cable cannot be recognized on 31<sup>st</sup> March 20X2 as the goods are not yet transferred to the customer Ethernet Bullet Ltd.'s factory premises, which is one of the critical obligations of Astra Ltd. The contention of the COO that it takes merely a few minutes to shift the goods, and hence the sale can be recognized does not hold true. One can always cross-question as to why the movement of goods did not happen if it was merely a few minutes job. It could be a possibility that the goods may not be packed, or there may still be some pending inspection of the goods before transferring the same etc. In view of this, the performance obligation under this contract has not been completed, and hence booking the revenue has resulted in an overstatement of revenue by ₹ 2 crores, and a consequent inflation of profits, assuming that Astra Ltd. is making profit on this sale transaction. Additionally, booking this sale has resulted in an understatement of inventory as at the reporting date of 31<sup>st</sup> March 20X2.

In view of the above, multiple conflicts of interest arise for Ms. Suparna Dasgupta:

**(a) Pressure to present favourable revenue figures and chartered accountant's personal circumstances**

The chartered accountant is under pressure to present favourable numbers, notably in favour of the COO, thereby increasing the incentives to the COO, and in turn benefiting with the continued job prospects. Thus, the ethical and professional standards required of the accountant are at odds with the pressures of her personal circumstances.

**(b) Duty to stakeholders**

The directors have a duty to act in the best interests of the company's stakeholders. While higher revenue numbers do indicate a good growth trajectory of the company, recognizing the revenue before fulfilling the performance obligations, or incorrectly booking grant income as revenue, results in misleading the stakeholders about the actual performance of the entity, thereby actually becoming detrimental to the stakeholders.

**Ethical principles guiding the chartered accountant's response**

By exhibiting bias in reporting higher revenue figures due to the risk of losing the job, objectivity stands compromised. Knowingly disclosing incorrect information compromises integrity, and erring in complying with Ind AS requirements, though continuing to report so in the financial statements, results in displaying absence of professional competence.

**Appropriate action**

In the given case, the chartered accountant faces an ethical dilemma, and must apply her moral and ethical judgment. As a professional, she is responsible for presenting the truth, and to avoid indulging in 'creative accounting practices' due to pressure.

The chartered accountant accordingly must put the interests of the company and professional ethics first and insist that the financial statements represent correct revenue numbers, in compliance with the relevant Ind AS. Being an advisor to the directors, she must prevent deliberate misrepresentation / fraudulent financial reporting, regardless of the personal consequences. The accountant should not allow any undue influence from the directors to override her professional judgment or integrity. This is in the long-term interests of the company,

Further, knowingly providing incorrect information is regarded as professional misconduct. To prevent such misconduct, the chartered accountant should not sign off on the financial statements containing incorrect financial information. By adhering to the ethical principles, the chartered accountant will maintain her professional integrity and contribute to the trust and reliability placed in the work expected from her.

However, if she signs the financial statements containing the inflated revenue numbers, Ms. Suparna Dasgupta would be guilty of professional misconduct under Clause I of Part II of Second Schedule to the Chartered Accountants Act, 1949. The Clause states that a member of the Institute, whether in practice or not, shall be guilty of professional misconduct, if he contravenes any of the provisions of this

Act or the regulations made thereunder, or any guidelines issued by the Council. As per the Council guidelines, a member of the Institute who is an employee shall exercise due diligence and shall not be grossly negligent in the conduct of his duties.

**13. Calculation of temporary differences and deferred tax for Joy Ltd. as on 31<sup>st</sup> March, 20X5** **Amount in ₹**

Item	Carrying amount	Tax base	Temporary Difference	Taxable/Deductible	DTA / (DTL) at 32%
Property Plant & Equipment	12,00,000	9,78,000 (W.N.1)	2,22,000	Taxable	(71,040)
Product Development Costs	60,000	0	60,000	Taxable	(19,200)
Trading investments	2,08,000	2,30,000	(22,000)	Deductible	7,040
Trade receivables	6,26,000	7,06,000 (W.N.2)	(80,000)	Deductible	25,600
Inventories	3,04,000	3,22,000	(18,000)	Deductible	5,760
Deferred income – Government grants	(40,000)	0	(40,000)	Excluded	0
Liability for product warranty costs	(16,000)	0	(16,000)	Deductible	5,120
Health care benefits for employees	(70,000)	0	(70,000)	Deductible	<u>22,400</u>
Total Deferred Tax Asset					65,920

Total Deferred Tax Liability					<u>(90,240)</u>
Net Deferred Tax Liability					<u>(24,320)</u>

**Working Notes:****1. Property Plant & Equipment as per tax records**

	₹
Cost of PPE	16,00,000
Less: Current tax depreciation	(2,06,000)
Less: Previous year tax depreciation	<u>(4,16,000)</u>
Tax base	<u>9,78,000</u>

**2. Trade receivables – Provision for doubtful debts:**

		₹
<b>Calculation of cost for tax records</b>		
Carrying amount		6,26,000
Add back: Bad debt provision		<u>1,30,000</u>
Cost A		7,56,000
Debtor A – ₹ 80,000 from 20X2-20X3		
>1 year – 20% deducted in 20X3-20X4	16,000	
>2 years – 30% deducted in 20X4-20X5	<u>24,000</u>	
Already deducted for tax	40,000	
Debtor B- ₹ 50,000 from 20X3-20X4		
>1 year – 20% deducted in 20X4-20X5	<u>10,000</u>	
Total deduction for tax purpose B		<u>(50,000)</u>
Tax base of trade receivables A-B		<u>7,06,000</u>

- 14.** As per Ind AS 23 'Borrowing Costs', the commencement date for capitalisation of borrowing cost on qualifying asset is the date when the entity first meets all of the following conditions:

- (a) it incurs expenditures for the asset;
- (b) it incurs borrowing costs; and
- (c) it undertakes activities that are necessary to prepare the asset for its intended use or sale.

Further, an entity also does not suspend capitalising borrowing costs when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale. For example, capitalisation continues during the extended period that high water levels delay construction of a bridge, if such high-water levels are common during the construction period in the geographical region involved.

An entity shall cease capitalising borrowing costs when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

Further, paragraph 23 explains that an asset is normally ready for its intended use or sale when the physical construction of the asset is complete even though routine administrative work might still continue. If minor modifications, such as the decoration of a property to the purchaser's or user's specification, are all that are outstanding, this indicates that substantially all the activities are complete.

In the given case since the site planning work started for the project on 1<sup>st</sup> June, 20X2, the commencement of capitalisation of borrowing cost will begin from 1<sup>st</sup> June, 20X2.

**(i) When landslide is not common in Shimla and delay in approval from District Administration Office is minor administrative work leftover**

In such a situation, suspension of capitalisation of borrowing cost on construction work will be considered for 3 months i.e. from October, 20X2 to December, 20X2 and cessation of capitalisation of borrowing cost shall stop at the time of completion of physical activities.

Accordingly, the borrowing cost to be capitalized will be effectively for 6 months i.e. from 1<sup>st</sup> June, 20X2 to



30<sup>th</sup> September, 20X2 and then from 1<sup>st</sup> January, 20X3 to 28<sup>th</sup> February, 20X3 i.e. total 6 months. The amount of borrowing cost will be ₹ 6,00,000 ( $1,00,00,000 \times 6/12 \times 12\%$ ).

**(ii) When landslide is common in Shimla and delay in approval from District Administration Office is major administrative work leftover**

Since landslides are common in Shimla during the monsoon period, there shall be no suspension of capitalisation of borrowing cost during that period.

Further, an asset can be considered to be ready for its intended use only on receipt of approvals and after compliance with regulatory requirements such as "Fire Clearances" etc. These are very important to declare the asset as ready for its scheduled operation.

In the given case, obtaining the safety approval is a necessary condition that needs to be complied with strictly and before obtaining the same the entity will not be able to use the building. Accordingly, it is appropriate to continue capitalisation until the said approvals are obtained.

Hence, the capitalisation of the borrowing cost will be for 9.5 months i.e. from 1<sup>st</sup> June, 20X2 till 15<sup>th</sup> March, 20X3. The amount of borrowing cost will be ₹ 9,50,000 ( $1,00,00,000 \times 9.5/12 \times 12\%$ ).

- 15.** Ind AS 10 'Events after the Reporting Date', classify an event as adjusting if it provides additional evidence of conditions existing at the reporting date. In this case the additional information relates to evidence of impairment of a financial asset since the customer had financial difficulties prior to 31<sup>st</sup> March 20X3.

Ind AS 109 'Financial Instruments' requires financial assets to be reviewed at each reporting date for evidence of impairment. Such evidence exists here because although the customer is expected to pay the amount due the payment date has been deferred. As per para B5.5.33 of Ind AS 109, for a financial asset that is credit-impaired at the reporting date, but that is not a purchased or originated credit-impaired financial asset, an entity shall measure the expected credit

losses as the difference between the asset's gross carrying amount and the present value of estimated future cash flows discounted at the financial asset's effective interest rate. Any adjustment is recognized in the profit or loss as an impairment gain or loss. Further, para B5.5.44 of Ind AS 109 provides that expected credit losses shall be discounted to the reporting date, not to the expected default or some other date, using the effective interest rate determined at initial recognition or an approximation thereof.

In such circumstances, Ind AS 109 requires that the financial asset be re-measured to the present value of the expected future receipt, discounted (in the case of a trade receivable) using effective interest rate. Therefore, in the financial statements for the year ended 31<sup>st</sup> March 20X3, asset should be measured at ₹ 55,04,587 (₹ 60,00,000/ 1.09) and an impairment loss of ₹ 4,95,413 (₹ 60,00,000 – ₹ 4,95,413) recognised in profit and loss.

In the year ended 31<sup>st</sup> March 20X4, interest income of ₹ 4,95,413 (₹ 55,04,587 x 9%) should be recognised in the profit and loss.

- 16.** Ind AS 2 deals with write-off in value of inventory. The stock of free items is valued at zero by the company. The question of "Loss of Inventory ₹ 2,50,000" does not arise as the claim of free stock is subject to various conditions like claim within 14 days, online registration within 3 days, etc. which are all contingent in nature.

A provision shall be recognised when:

- (a) an entity has a present obligation (legal or constructive) as a result of a past event;
- (b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- (c) a reliable estimate can be made of the amount of the obligation.

If these conditions are met, provision shall be recognised.

Here, provision is to be made for goods to be distributed because sale took place in the reporting year and assuming that the registration for the contest are received whereby there is a high probability that the

customer can claim the free items within 14 days from the date of invoice. Further, a reliable estimate of the claim of ₹ 2,50,000 can be made. Hence provision of ₹ 2,50,000 is to be made for in the reporting year's financial statements.

Further, on expiry of the time period, where claim had not been made by the customers, reversal of provision will be done in the next financial year.

**17. Statement of Cash Flows for the year ended 31<sup>st</sup> March, 20X3**

	(₹ in lakhs)	(₹ in lakhs)
<b>Cash flows from operating activities</b>		
Profit before taxation	200	
Adjustments for non-cash items:		
Depreciation [410 - (450 - 100)]	<u>60</u>	
	260	
Increase in inventories (800 - 700)	(100)	
Decrease in trade receivables (600 - 580)	20	
Increase in other non-current assets (Refer Note 2) (95 - 85)	(10)	
Increase in other current assets (160 - 120)	(40)	
Increase in non-current liabilities (Refer Note 2) (90 - 80)	10	
Decrease in trade payables (455 - 25 - 450)	(20)	
Other current liabilities (Refer Note 1) [(90+40)-45]	<u>(85)</u>	
<i>Net cash generated from operating activities</i>		35
<b>Cash flows from investing activities</b>		
Cash paid to purchase PPE (100-25)	(75)	
Cash paid to acquire investment (100-60)	<u>(40)</u>	
<i>Net cash outflow from investing activities</i>		(115)

<b>Cash flows from financing activities</b>		
Raising of equity share capital (280 - 250)	30	
Long-term borrowings raised during the year	120	
Long-term borrowings repaid during the year (300 + 120) - 360]	<u>(60)</u>	
<i>Net cash outflow from financing activities</i>		90
Increase in cash and cash equivalents during the year		10
Cash and cash equivalents at the beginning of the year (420-300)		<u>(120)</u>
Cash and cash equivalents at the end of the year (410-300)		<u>(110)</u>

**Notes:**

1. Other current liabilities are assumed to consist of provision for taxation.
  2. Other non-current assets and other non-current liabilities pertain to working capital items.
- 18.** Paragraph 22 of Ind AS 115 provides that at contract inception, an entity evaluates the promised goods or services to determine which goods or services (or bundle of goods or services) are distinct and therefore constitute a performance obligation.

A performance obligation is a promise in a contract to transfer to the customer either:

- a goods or service (or a bundle of goods or services) that is distinct; and
- series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

As per paragraph 27 of Ind AS 115, a goods or service that is promised to a customer is distinct if both of the following criteria are met:

- (a) the customer can benefit from the goods or service either on its own or together with other resources that are readily available to the customer (i.e. the goods or service is capable of being distinct); and
- (b) the entity's promise to transfer the goods or service to the customer is separately identifiable from other promises in the contract (i.e. the promise to transfer the goods or service is distinct within the context of the contract).

Each performance obligation is required to be accounted for separately. The facts and circumstances of each contract should be carefully considered to determine the performance obligations.

However, based on the above guidance, the following table in general discusses whether the common goods and services in property sale contract should be considered as separate performance obligation or not:

<b>Goods / Service</b>	<b>Whether a separate performance obligation (PO) or not</b>	<b>Reason</b>
Common areas	Unlikely to be separate PO	Common areas are unlikely to be a separate PO because the interests received in common areas are typically undivided interests that are not separable from the property itself.  However, if the common areas were sold separately by the developer, then they could be considered as a separate PO provided that it is distinct in the context of the contract.

Construction services and building materials	Unlikely to be separate PO	Construction services and building materials can meet the first criterion as they are items that can be used in conjunction with other readily available goods or services. However, the developer would be considered to be providing a significant integration service as it is bringing together all the separate elements to deliver a completed building.
Property management services and Golf membership	Likely to be separate PO	Property management services and golf membership are likely to be separate PO as they may be used in isolation or with the property already acquired, i.e., management services can be used with the property.  These types of services are not significantly customised, integrated with, or dependent on the property. This is because there is no change in their function with or without the property. Also, a property management service could be undertaken by a third party.
Car park and Land entitlement	Analysis required	Items such as car parks and land entitlements generally meet the first criterion – i.e., capable of being distinct – as the buyer benefits from them on their own.

		<p>Whether the second criterion is met depends on the facts and circumstances. For example, if the land entitlement can be sold separately or pledged as security as a separate item, it may indicate that it is not highly dependent on, or integrated with, other rights received in the contract.</p> <p>In an apartment scenario, the customer can receive an undivided interest in the land on which the apartment block sits. This type of right is generally considered a highly inter-related with the apartment itself.*</p>
--	--	---

*\*However, if title to the land is transferred to the buyer separately – for example in a single party development – then the separately identifiable criterion may be met.*

19. Paragraph 25 of Ind AS 110 states that, "if a parent loses control of a subsidiary, the parent:
- derecognises** the assets and liabilities of the former subsidiary from the consolidated balance sheet.
  - recognises** any investment retained in the former subsidiary at its fair value when control is lost and subsequently accounts for it and for any amounts owed by or to the former subsidiary in accordance with relevant Ind AS. That fair value shall be regarded as the fair value on initial recognition of a financial asset in accordance with Ind AS 109 or, when appropriate, the cost on initial recognition of an investment in an associate or joint venture.

- (c) **recognises** the gain or loss associated with the loss of control attributable to the former controlling interest.”

Paragraph B98(c) of Ind AS 110 states that, on loss of control over a subsidiary, a parent shall reclassify to profit or loss, or transfer directly to retained earnings if required by other Ind AS, the amounts recognised in other comprehensive income in relation to the subsidiary on the basis specified in paragraph B99.

As per paragraph B99, if a parent loses control of a subsidiary, the parent shall account for all amounts previously recognised in other comprehensive income in relation to that subsidiary on the same basis as would be required if the parent had directly disposed of the related assets or liabilities. Therefore, if a gain or loss previously recognised in other comprehensive income would be reclassified to profit or loss on the disposal of the related assets or liabilities, the parent shall reclassify the gain or loss from equity to profit or loss (as a reclassification adjustment) when it loses control of the subsidiary. If a revaluation surplus previously recognised in other comprehensive income would be transferred directly to retained earnings on the disposal of the asset, the parent shall transfer the revaluation surplus directly to retained earnings when it loses control of the subsidiary.

In view of the basis in its consolidated financial statements, AB Limited shall:

- (a) re-classify the FVOCI reserve in respect of the debt investments of ₹ 5.4 crore (90% of ₹ 6 crore) attributable to the owners of the parent to the statement of profit or loss in accordance with paragraph B5.7.1A of Ind AS 109, Financial Instruments which requires that the cumulative gains or losses previously recognised in OCI shall be recycled to profit and loss upon derecognition of the related financial asset. This is reflected in the gain on disposal. Remaining 10% (i.e., ₹ 0.6 crore) relating to non-controlling interest (NCI) is included as part of the carrying amount of the non-controlling interest that is derecognised in calculating the gain or loss on loss of control of the subsidiary.



- (b) transfer the reserve relating to the net measurement losses on the defined benefit liability of ₹ 2.7 crore (90% of ₹ 3 crore) attributable to the owners of the parent within equity to retained earnings. It is not reclassified to profit or loss. The remaining 10% (i.e., ₹ 0.3 crore) attributable to the NCI is included as part of the carrying amount of NCI that is derecognised in calculating the gain or loss on loss of control over the subsidiary. No amount is reclassified to profit or loss, nor is it transferred within equity, in respect of the 10% attributable to the non-controlling interest.
- (c) reclassify the cumulative gain on fair valuation of equity investment of ₹ 3.6 crore (90% of ₹ 4 crore) attributable to the owners of the same parent from OCI to retained earnings under equity as per paragraph B5.7.1 of Ind AS 109, Financial Instruments, which provides that in case an entity has made an irrevocable election to recognise the changes in the fair value of an investment in an equity instrument not held for trading in OCI, it may subsequently transfer the cumulative amount of gains or loss within equity. The remaining 10% (i.e., ₹ 0.4 crore) related to the NCI are derecognised along with the balance of NCI and not reclassified to profit and loss.
- (d) reclassify the foreign currency translation reserve of ₹ 7.2 crore (90% × ₹ 8 crore) attributable to the owners of the parent to statement of profit or loss as per paragraph 48 of Ind AS 21 'The Effects of Changes in Foreign Exchange Rates', which specifies that the cumulative amount of exchange differences relating to the foreign operation, recognised in OCI, shall be reclassified from equity to profit or loss on the disposal of foreign operation. This is reflected in the gain on disposal. Remaining 10% (i.e., ₹ 0.8 crore) relating to the NCI is included as part of the carrying amount of the NCI that is derecognised in calculating the gain or loss on the loss of control of subsidiary, but is not reclassified to profit or loss in pursuance of paragraph 48B of Ind AS 21, which provides that the cumulative exchange differences relating to that foreign operation attributed to NCI shall be derecognised on disposal of the foreign operation, but shall not be reclassified to profit or loss.

The impact of loss of control over BC Limited on the consolidated financial statements of AB Limited is summarised below: (**₹ in crore**)

Particular	Amount (Dr)	Amount (Cr)	P&L Impact	RE Impact
<b>Gain / Loss on Disposal on Investments</b>				
Bank	56			
Non-controlling interest (Derecognised)	6			
Investment at FV (20% Retained)	16			
Gain on Disposal (P&L) balancing figure		18	18	
De-recognition of total net assets of subsidiary	60			
<b>Reclassification of FVTOCI reserve on debt instruments to profit or loss</b>				
FVTOCI reserve on debt instruments (6 cr. x 90%)	5.4			
To Profit and loss		5.4	5.4	
<b>Reclassification of net measurement loss reserve to profit or loss</b>				
Reserve and Surplus	2.7			-2.7
To Net measurement loss reserve (FVTOCI) [(3 cr. x 90%)]		2.7		

<b>Reclassification of FVTOCI reserve on equity instruments to retained earnings</b>				
FVTOCI reserve on equity instruments (4 crux 90%)	3.6			
To Reserve and Surplus		3.6	3.6	
<b>Foreign currency translation reserve reclassified to profit or loss</b>				
Foreign currency translation reserve (FVOCI) [8 cr. x 90%]	7.2			
To Profit and loss		7.2	<u>7.2</u>	<u>    </u>
<b>Total</b>			<b><u>30.6</u></b>	<b><u>0.9</u></b>

20. As per para 10 of Ind AS 102, for equity settled share-based payment transactions, the entity shall measure the goods or services received, and the corresponding increase in equity, directly, at the fair value of the goods or services received, unless that fair value cannot be estimated reliably. If the entity cannot estimate reliably the fair value of the goods or services received, the entity shall measure their value, and the corresponding increase in equity, indirectly, by reference to the fair value of the equity instruments granted. Here, since the fair value of the asset received can be estimated reliably, the price for recording the machinery would be ₹ 160 lakhs.

Further, as per para 7 of Ind AS 102, the control is assumed to be transferred on the date the delivery is received which is 1<sup>st</sup> November, 20X2. Therefore, this will be the date for recognizing the machinery in the books.

Property, plant and equipment	Dr.	₹ 160 lakhs	
To Equity share capital			₹ 100 lakhs
To Securities premium			₹ 60 lakhs



## PAPER – 2

# ADVANCED FINANCIAL MANAGEMENT

---



### QUESTIONS

#### Securitization

1. Grow More Ltd. an NBFC is in the need of funds and hence it sold its receivables to MAC Financial Corporation (MFC) for ₹ 100 million. MFC created a trust for this purpose called General Investment Trust (GIT) through which it issued securities carrying a different level of risk and return to the investors. Further, this structure also permits the GIT to reinvest surplus funds for short term as per their requirement.

MFC also appointed a third party, Safeguard Pvt. Ltd. (SPL) to collect the payment due from obligor(s) and passes it to GIT. It will also follow up with defaulting obligor and if required initiate appropriate legal action against them.

**Based on above scenario, answer the following questions:**

- I. The securitized instrument issued for ₹ 100 million by the GIT falls under category of .....
  - (a) Pass Through certificate (PTCs)
  - (b) Pay Through Security (PTS)
  - (c) Stripped Security
  - (d) Debt Fund.
- II. In the above scenario, the Originator is.....
  - (a) Grow More Ltd.
  - (b) MAC Financial Corporation (MFC)

- (c) General Investment Trust (GIT)
  - (d) Safeguard Pvt. Ltd.
- III. In the above scenario, the General Investment Trust (GIT) is a/an.....
- (a) Obligor
  - (b) Originator
  - (c) Special Purpose Vehicle (SPV)
  - (d) Receiving and Paying Agent (RPA)
- IV. In the above scenario, the Safeguard Pvt. Ltd. (SPL) is a/an.....
- (a) Obligor
  - (b) Originator
  - (c) Special Purpose Vehicle (SPV)
  - (d) Receiving and Paying Agent (RPA)
- V. Which of the following statement holds true?
- (a) When Yield to Maturity in market rises, prices of Principle Only (PO) Securities tend to rise.
  - (b) When Yield to Maturity in market rises, prices of Principle Only (PO) Securities tend to fall.
  - (c) When Yield to Maturity in market falls, prices of Principle Only (PO) Securities tend to fall.
  - (d) When Yield to Maturity in market falls, prices of Principle Only (PO) Securities remain the same.

### Security Analysis

2. You are a financial analyst at a prominent investment firm and have been tasked with empirically verifying the weak form of Efficient Market Hypothesis (EMH) Theory for the XYZ Stock Index, a collection of diverse stocks. You decided to conduct three different tests to assess whether the stock market follows the principles of the weak form of EMH.

**Test 1**

For the past five years, you collected daily price changes of the stocks in the XYZ Stock Index. You calculated correlation coefficients for different lag periods and analyzed whether past price changes exhibit any significant correlation with future price changes. You considered price changes to be serially independent. The results indicated that most auto correlation coefficients are close to zero and statistically insignificant, suggesting those past price changes do not predict future price changes.

**Test 2**

You further investigated the randomness of price changes in the XYZ Stock Index. Analyzing the sequence of daily price changes, you count the number of runs where price changes are consistently positive or negative. Upon comparing the observed number of runs with the expected number based on randomness, you find that they align closely, supporting the idea that price changes follow a random pattern.

**Test 3**

To examine the efficacy of trading strategies based on historical price trends, you implemented a simple trading rule for the XYZ Stock Index. The rule involves buying when the price crosses a moving average of 5% threshold and selling when it crosses another 7% threshold. Over a period of testing, you computed the returns generated by the trading strategy. The results revealed that the returns are not consistently better than random chance, implying that past price trends do not reliably predict future price movements.

**Conclusion:**

After conducting the three tests the evidence supports the weak form of Efficient Market Theory for the XYZ Stock Index you concluded that past price trends do not reliably predict future price movements.

**Based on the above information answer the following questions:**

- I. Test 1 is .....
  - (a) Serial Correlation test
  - (b) Filter Rules test

- (c) Run test
- (d) Variance Ratio test
- II. Test 2 is .....
  - (a) Serial Correlation test
  - (b) Filter Rules test
  - (c) Run test
  - (d) Variance Ratio test
- III. Test 3 is .....
  - (a) Serial Correlation test
  - (b) Filter Rules test
  - (c) Run test
  - (d) Variance Ratio test.
- IV. The Filter Rule Test should not be applied for buy and hold strategy if.....
  - (a) the behavior of stock price changes is predictable.
  - (b) the behavior of stock price changes is dependent on past trends.
  - (c) the behavior of stock price changes is correlated.
  - (d) the behavior of stock price changes is random.
- V. Results of your studies support the.....
  - (a) Semi-strong EMH Theory
  - (b) Strong EMH Theory
  - (c) Random Walk Theory
  - (d) Markowitz Theory

**Derivatives Analysis and Valuation**

3. Mr. Shyam an investor is not sure about the expected price movement of the stock of Delta Corporation's share. His friend Adi advised him to go for option contracts if he wants to play in the market with limited risk. Adi

advised him to follow below mentioned Strategy.

- (1) Purchase one 3-month call option with a premium of ₹ 30 and an exercise price of ₹ 550.
- (2) Purchase one 3-month put option with a premium of ₹ 5 and an exercise price of ₹ 450.

Delta Corporation's stock is currently selling at ₹ 500.

Demonstrate the net pay off position of Mr. Shyam at the expiry of option after 3-months if the price of Delta Corporation's stock happens to be:

- (i) No change in price
- (ii) falls at ₹ 350
- (iii) rises to ₹ 600.

Assume the option lot size is 100.

4. The price of ACC stock on 31 December 2022 was ₹ 220 and the Futures price on the same stock on the same date, i.e., 31 December 2022 for March 2023 was ₹ 222. Other features of the Futures contract and related information are as follows:

Time to expiration	-	3 months (0.25 year)
Borrowing rate	-	15% p.a.
Annual Dividend on the stock	-	25% payable before 31.03. 2023
Face Value of the Stock	-	₹ 10

Advise the investor the course of action to be followed by him so as to earn Risk free income if he can sell the stock short at spot price.

#### Business Valuation

5. The following information is given for 3 companies that are identical except for their capital structure:

	Orange	Grape	Apple
Total invested capital	1,00,000	1,00,000	1,00,000
Debt/assets ratio	0.8	0.5	0.2
Pre-tax cost of debt	16%	13%	15%



Cost of equity	26%	22%	20%
Operating Income (EBIT)	25,000	25,000	25,000

The tax rate is uniform 35% in all cases.

**Required:**

- Compute the Weighted Average Cost of Capital of each company.
- Tabulate the Economic Value Added (EVA) of each company.
- If the industry PE ratio is 11x and stock prices of Orange, Grape and Apple are ₹ 14.30, ₹ 15.95 and ₹ 15.73 respectively then calculate the no. of shares issued by each company.
- Advise whether same Industry PE ratio can be used to calculate market price of share of each company.
- Tabulate market Capitalisation for each of the Companies.

**Foreign Exchange Exposure and Risk Management**

- JKL Ltd., an Indian company has an export exposure of JPY 10,000,000 receivable December 31, 2022. Japanese Yen (JPY) is not directly quoted against Indian Rupee.

The current spot rates are:

INR/US \$ = ₹ 82.22

JPY/US\$ = JPY 132.34

It is estimated that Japanese Yen will depreciate to 154 against US \$ and Indian Rupee to depreciate to ₹ 85 against US \$.

Forward rates as on date for 31<sup>st</sup> December 2022 are as follows:

INR/US \$ = ₹ 86.50

JPY/US\$ = JPY 140.35

**Required:**

- Evaluate the expected loss based on estimated rates if the hedging is not done.
- Justify the decision to take forward cover even if actual rates on December 31, 2022 happens to be as follows:

INR/US \$ = ₹ 86.25

JPY/US\$ = JPY 140.85

**Note:** Make calculation of ₹ rate in ₹ upto 4 decimal points.

7. A UK based exporter exported goods to USA. The Invoice amount is \$ 7,00,000 and credit period is 3 months. Exchange rates in London are as follows: -

Spot Rate (\$/£) 1.5865 – 1.5905

3-month Forward Rate (\$/£) 1.6100 – 1.6140

Rates of interest in Money Market:

	Deposit	Loan
\$	7%	9%
£	5%	8%

Justify your stand to choose money market hedge (including steps) instead of Forward Contract.

**Note:** Make calculation upto 2 decimal points.

#### Advanced Capital Budgeting Decisions

8. X Ltd. is considering its new project with the following details:

Sr. No.	Particulars	Figures
1.	Initial capital cost	₹ 400 Cr.
2.	Annual unit sales	5 Cr.
3.	Selling price per unit	₹ 100
4.	Variable cost per unit	₹ 50
5.	Fixed costs per year	₹ 50 Cr.
6.	Discount Rate	6%

**Required:**

- (i) Tabulate the NPV of the project. Does it represent the actual outcome? Comment.

- (ii) Examine the impact of 2.5 percent adverse variance in each of the variables on the project's NPV. Decide which variable is having maximum effect?
- (iii) Critically analyse the Sensitivity analysis as method of incorporating risk in capital budgeting decisions.

Consider Life of the project as 3 years.

#### Interest Rate Risk Management

9. A Inc. and B Inc. intend to borrow \$ 200,000 and \$ 200,000 in ₹ respectively for a time horizon of one year. The prevalent interest rates are as follows:

Company	₹ Loan	\$ Loan
A Inc	5%	9%
B Inc	8%	10%

The prevalent exchange rate is \$ 1 = ₹ 120.

They entered in a currency swap under which it is agreed that B Inc will pay A Inc @ 1% over the ₹ Loan interest rate which the later will have to pay as a result of the agreed currency swap whereas A Inc will reimburse interest to B Inc only to the extent of 9%.

Keeping the exchange rate invariant, assess and analyse the opportunity gain or loss component of the ultimate outcome, resulting from the designed currency swap.

#### Mutual Fund

10. There are two Mutual Funds viz. D Mutual Fund Ltd. and K Mutual Fund Ltd. Each having close ended equity schemes.

NAV as on 31-12-2022 of equity schemes of D Mutual Fund Ltd. is ₹ 70.71 (consisting 99% equity and remaining cash balance) and that of K Mutual Fund Ltd. is ₹ 62.50 (consisting 96% equity and balance in cash).

Following is the other information:

Particular	Equity Schemes	
	D Mutual Fund Ltd.	K Mutual Fund Ltd.
Sharpe Ratio	2	3.3
Treynor Ratio	15	15
Standard deviation	11.25	5
Risk free rate of return ( $R_f$ )	7%	

There is no change in portfolios during the next month and annual average cost is ₹ 3 per unit for the schemes of both the Mutual Funds.

**Required:**

- Tabulate the expected NAVs of both the schemes if share market goes down by 5% within a month.
- Advise which mutual fund should an investor choose from the perspective of risk per unit of return.

**Note:** For calculation purpose, consider 12 months in a year and ignore number of days for a particular month.

**Portfolio Management**

- An investor has decided to invest ₹ 1,00,000 in the shares of two companies, namely, ABC and XYZ. The projections of returns from the shares of the two companies along with their probabilities are as follows:

Probability	ABC (%)	XYZ (%)
0.20	12	16
0.25	14	10
0.25	-7	28
0.30	28	-2

**Required:**

- Comment on return and risk of investment in individual shares.
- Compare the risk and return of these two shares with a Portfolio of these shares in equal proportions.

- (iii) Advise the proportion of each of the above shares to formulate a minimum risk portfolio.

### Security Valuation

12. Mr. Amit is happy with the investment in a company as it is paying good dividend for the last few years. Last year it paid a dividend of ₹ 2 per share. The share is currently trading at ₹ 150 per share. He is of view that if he applies dividend discount model, the share is undervalued. As a financial expert examine his view that dividend discount model represents the fair value.

You being an expert is required to evaluate the market value of the share of the company.

Profit after tax of the company	₹ 290 crores
Equity capital of company	₹ 1,300 crores
Par value of share	₹ 40 each
Debt ratio of company (Debt/ Debt + Equity)	27%
Long run growth rate of the company	8%
Beta 0.1; risk free interest rate	8.7%
Market returns	10.3%
Capital expenditure per share	₹ 47
Depreciation per share	₹ 39
Change in Working capital	₹ 3.45 per share

**Note:** Round off figures (e.g. EPS etc.) upto 2 decimal points.

### International Financial management

13. Mr. Vishwas, a friend of Mr. Pramod who is one of the Directors of Ashirwad Limited, is a citizen of Mauritius. His immediate family members including his parents, born in India are residing in India. He has many friends in different parts of India, due to which he happens to visit India on frequent basis. He along with Mr. Pramod evince interest in setting up business in India and formally incorporate a company to commence their operations. Accordingly, a company is called "Aerious Private Ltd." got incorporated in Mumbai.

To start with he received a business proposal from one of his friends Nimish a consultant. It is estimated that in equivalent terms the business shall require an initial investment of MUR 100 Million and thereafter MUR 2 Million each year will be needed as working capital fund.

He wished to evaluate whether the business proposal is viable or not. The information related to exchange rate and inflation rate is as follows:

Spot Rate for 1 Mauritian Dollar (MUR) = 1.88 Indian Rupee (INR)

The inflation in India is 6% and in Mauritius is 5%.

It is expected that this inflation rate will remain unchanged for the next 4 years.

INR 8 Crore out of initial investment shall be required for setting up a plant. The useful life of the plant is 4 years. At the end of 4<sup>th</sup> year estimated salvage value of this plant shall be INR 80 lakhs. Depreciation of the plant shall be charged on the basis of straight-line method.

40 % of the investment shall be through debt funds from Mauritius at the cost of 10% (post tax) while remaining funds shall be arranged by him and his friends. They expect a rate of return of 12% on their funds.

Expected revenues & costs (excluding depreciation) in real term are as under:

Year	1	2	3	4
Revenues (₹ Crore)	6.00	7.00	8.00	8.00
Costs (₹ Crore)	3.00	4.00	4.00	4.00

Assume that applicable tax rate in India is 30%. Since there is Double tax avoidance agreement between India and Mauritius, the company is not required to pay tax in Mauritius if tax has been paid in India.

The applicable inflation rates for revenues & costs are as follows:

Year	Revenues	Costs
1	10%	12%
2	9%	10%
3	8%	9%
4	7%	8%

He wants an expert opinion for the same investment proposal.

Demonstrate whether investment in this project is viable option or not.

- Note:** 1. Round off calculations upto 4 decimal points.  
2. Show INR calculations in Crore and MUR calculations in Million.

### Theoretical Questions

14. Succession planning is a good way for companies to ensure that businesses are fully prepared to promote and advance all employees—not just those who are at the management or executive levels. Explain the above statement.
15. In the current scenario of globalization and growth in information and communication technologies etc. the responsibilities of CFOs have been drastically expanded. Explain.



### SUGGESTED ANSWERS/HINTS

1.

I	(b)
II	(b)
III	(c)
IV	(d)
V	(b)

2.

I	(a)
II	(c)
III	(b)
IV	(d)
V	(c)

3. Total premium paid on purchasing a call and put option  
= (₹ 30 per share × 100) + (₹ 5 per share × 100)  
= ₹ 3,000 + ₹ 500 = ₹ 3,500

(i) Net Pay-off if there is no change in price

In this case, Mr. Shyam exercises neither the Call option nor the Put option as both will result in a loss for him.

Ending value = - ₹ 3,500 + Zero gain = - ₹ 3,500

i.e. Net loss is ₹ 3,500

(ii) Net Pay-off if price falls at ₹ 350

Since the price of the stock is below the exercise price of the Call, it will not be exercised. Only Put is valuable hence it is exercised.

Ending value = - ₹ 3,500 + ₹ [(450 - 350) × 100] = - ₹ 3,500 + ₹ 10,000 = ₹ 6,500

∴ Net gain is ₹ 6,500

(iii) Net Pay-off if price rises to ₹ 600

In this situation, the put is worthless since the price of the stock exceeds the Put's exercise price. Only Call is valuable and hence it is exercised.

Ending value = - ₹ 3,500 + ₹ [(600 - 550) × 100] = - ₹ 3,500 + ₹ 5,000 = ₹ 1,500

∴ Net Gain is ₹ 1,500

4. Based on the above information, the futures price for ACC stock on 31 December 2022 should be:

Spot price + Interest Portion – Dividend

= 220 + (220 × 0.15 × 0.25) – (0.25 × 10) = 225.75

Thus, as per the 'cost of carry' criteria, the Futures price is ₹ 225.75, which is more than the actual price of ₹ 222 on 31 March 2023. This would give rise to earn riskless arbitrage opportunity of ₹ 3.75 i.e. (225.75 - 222)

**Advise to the Arbitrager.**

1. Short sell one unit of stock at spot price for ₹ 220.
2. Deposit ₹ 220 at 15% p.a. for 3 months.
3. Buy a 3-month Futures contract for one unit of stock of ACC at ₹ 222.



**After 3 months**

1. Take money out of the Bank.
2. Take delivery by paying ₹ 222 and return the unit of stock to the party whom short sell was made along.
3. Pay the Dividend amount to the buyer whom short sell was made.

$$\text{Total Inflow} = 220 + (220 \times 0.15 \times 0.25) = ₹ 228.25$$

$$\text{Total Outflow} = 222 + 2.50 = ₹ 224.50$$

$$\text{Net Gain to the Arbitrager} = \text{Total Inflow} - \text{Total Outflow}$$

$$= ₹ 228.25 - ₹ 224.50$$

$$= ₹ 3.75$$

Thus, the arbitrager earns ₹ 3.75 per share without involving any risk.

5. (i) **Calculation of WACC of each company**

	Orange	Grape	Apple
Total debt (₹)	80,000	50,000	20,000
Post tax Cost of debt	10.40%	8.45%	9.75%
Equity Fund (₹)	20,000	50,000	80,000

**WACC**

$$\text{Orange:} \quad (10.4 \times 0.8) + (26 \times 0.2) = 13.52\%$$

$$\text{Grape:} \quad (8.45 \times 0.5) + (22 \times 0.5) = 15.225\%$$

$$\text{Apple:} \quad (9.75 \times 0.2) + (20 \times 0.8) = 17.95\%$$

(ii) **Economic Valued Added (EVA) of each company**

	Orange	Grape	Apple
WACC	13.52	15.225	17.95
EBIT (1-T) (A)	16,250	16,250	16,250
WACC x Invested Capital (B)	13,520	15,225	17,950
EVA [(A) – (B)]	2,730	1,025	-1,700

Orange would be considered as the best investment since the EVA of the company is highest and its weighted average cost of capital is the lowest.

**(iii) No. of shares issued by each company**

	Orange	Grape	Apple
EBIT (₹)	25,000	25,000	25,000
Interest (₹)	12,800	6,500	3,000
Taxable Income (₹)	12,200	18,500	22,000
Tax 35% (₹)	4,270	6,475	7,700
Net Income (₹)	7,930	12,025	14,300
Stock Price (EPS x PE Ratio) (₹)	14.30	15.95	15.73
No. of shares	(7930x11)/ 14.30 = 6100	(12025x11)/1 5.95 = 8293	(14300x11)/1 5.73 = 10000

**(iv)** Since the three entities have different capital structures, they would be exposed to different degrees of financial risk. The PE ratio should therefore be adjusted for the risk factor.

**(v) Market Capitalisation**

	Orange	Grape	Apple
Estimated Stock Price (₹)	14.30	15.95	15.73
No. of shares	6,100	8,293	10,000
Estimated Market Cap (₹)	87,230	1,32,273.35	1,57,300

- 6.** Since the direct quote for ¥ and ₹ is not available it will be calculated by cross exchange rate as follows:

$$\text{₹}/\$ \times \$/\text{¥} = \text{₹}/\text{¥}$$

$$82.22/132.34 = 0.6213$$

$$\text{Spot rate on date of export } 1 \text{ ¥} = \text{₹ } 0.6213$$

$$\text{Estimated Rate of ¥ for Dec.31, 2022} = \text{₹ } 0.5519 (\text{₹ } 85/\text{¥ } 154)$$

Forward Rate of ₹ for Dec.31, 2022 = ₹ 0.6163 (₹ 86.50/ ¥ 140.35)

(i) The expected loss without hedging

Value of export at the time of export (₹ 0.6213 x ¥ 10,000,000)	₹ 62,13,000
Expected payment to be received on 31 <sup>st</sup> Dec. 2022 as per estimated rates (₹ 0.5519 x ¥ 10,000,000)	₹ 55,19,000
Loss	₹ 6,94,000

(ii) (a) Hedging of loss under Forward Cover

Value of export at the time of export (₹ 0.6213 x ¥ 10,000,000)	₹ 62,13,000
Payment expected to be received under Forward Cover (₹ 0.6163 x ¥ 10,000,000)	₹ 61,63,000
Loss	₹ 50,000

Thus, by taking forward cover loss is reduced to ₹ 50,000 from ₹ 6,94,000

(b) Actual Rate of ₹ on December 2022 = ₹ 0.6124 (₹ 86.25/ ¥ 140.85)

Value of export at the time of export (₹ 0.6213 x ¥ 10,000,000)	₹ 62,13,000
Payment to be received on 31 <sup>st</sup> Dec. 2022 as per actual rate (₹ 0.6124 x ¥ 10,000,000)	₹ 61,24,000
Loss	₹ 89,000

From the above solution, we can find that net loss in actual situation is ₹ 89,000 while net loss when taken Forward Cover is only ₹ 50,000. Hence, the decision to take Forward Cover is justified even if the actual rate happens to be as prescribed.

7. Amount expected to be received under Money Market Hedge.

**Identify:** Foreign currency is an asset. Amount \$ 7,00,000.

**Create:** \$ Liability.

**Borrow:** In \$. The borrowing rate is 9% per annum or 2.25% per quarter.

**Amount to be borrowed:**  $7,00,000 / 1.0225 = \$ 6,84,596.58$

**Convert:** Sell \$ and buy £. The relevant rate is the Ask rate, namely, 1.5905 per £,

(**Note:** This is an indirect quote).

Amount of £s received on conversion is 4,30,428.53 ( $6,84,596.58 / 1.5905$ ).

**Invest:** £ 4,30,428.53 will be invested at 5% for 3 months and get £ 4,35,808.89

**Settle:** The liability of \$ 6,84,596.58 at interest of 2.25 per cent quarter matures to \$7,00,000 receivable from customer.

Using forward rate, amount receivable is =  $7,00,000 / 1.6140 = £ 4,33,705.08$

Amount received through money market hedge = £ 4,35,808.89

Gain = £ 4,35,808.89 – £ 4,33,705.08 = £ 2103.81

**Justification:** By following the prescribed steps under hedging we found the exporter receives £ 4,33,705.08 by using forward cover while he receives £ 4,35,808.89 through money market hedge. Thus, money market hedge helps exporter to receive £ 2103.81 more than the amount received using Forward contract. Hence it is more beneficial.

8. (i) **Calculation of Net Cash Inflow per year**

	Particulars	Amount (₹)
A	Selling price per unit	100
B	Variable cost per unit	50
C	Contribution per unit (A - B)	50
D	Number of units sold per year	5 Cr.
E	Total Contribution (C × D)	₹ 250 Cr.
F	Fixed cost per year	₹ 50 Cr.
G	Net cash inflow per year (E - F)	₹ 200 Cr.

**Calculation of Net Present Value (NPV) of the Project**

Year	Year Cash Flow (₹ in Cr.)	PV factor @ 6%	Present Value (PV) (₹ in Cr.)
0	(400.00)	1.000	(400.00)
1	200.00	0.943	188.60
2	200.00	0.890	178.00
3	200.00	0.840	168.00
Net Present Value			134.60

Here, NPV represent the most likely outcomes and not the actual outcomes. The actual outcome can be lower or higher than the expected outcome.

- (ii) Sensitivity Analysis considering 2.5 % Adverse Variance in each variable

	Particulars	Base	Initial capital cost increased to ₹ 410 crore	Selling Price per Unit Reduced to ₹ 97.5	Variable Cost Per Unit increased to ₹ 51.25	Fixed Cost Per Unit increased to ₹ 51.25	Units sold per year reduced to 4.875 crore
		(₹)	(₹)	(₹)	(₹)	(₹)	(₹)
A	Selling price per unit	100	100	97.50	100	100	100
B	Variable cost per unit	50	50	50	51.25	50	50
C	Contribution per unit (A - B)	50	50	47.50	48.75	50	50
		(₹ in Cr.)	(₹ in Cr.)	(₹ in Cr.)	(₹ in Cr.)	(₹ in Cr.)	(₹ in Cr.)
D	Number of units sold per year (units in Crores)	5	5	5	5	5	4.875
E	Total	250	250	237.50	243.75	250	243.75

	Contribution (C × D)						
F	Fixed cost per year	50	50	50	50	51.25	50
G	Net Cash Inflow per year (E - F)	200	200	187.50	193.75	198.75	193.75
H	PV of Net cash Inflow per year (G × 2.673)	534.60	534.60	501.19	517.89	531.26	517.89
I	Initial capital cost	400	410	400	400	400	400
J	NPV (H - I)	134.60	124.60	101.19	117.89	131.26	117.89
K	Percentage Change in NPV	-	-7.43%	-24.82%	-12.41%	-2.48%	-12.41%

The above table shows that by changing one variable at a time by 2.5% (adverse) while keeping the others constant, the impact in percentage terms on the NPV of the project can be calculated. Thus, the change in selling price has the maximum effect on the NPV by 24.82%.

#### Advantages of Sensitivity Analysis:

Following are the main advantages of Sensitivity Analysis:

- (1) **Critical Issues:** This analysis identifies critical factors that impinge on a project's success or failure.
- (2) **Simplicity:** It is a simple technique.

#### Disadvantage of Sensitivity Analysis

Following are the main disadvantages of Sensitivity Analysis:

- (1) **Assumption of Independence:** This analysis assumes that all variables are independent i.e. they are not related to each other, which is unlikely in real life.

- (2) **Ignore probability:** This analysis does not look to the probability of changes in the variables

9. **Opportunity gain of A Inc under currency swap**

	Receipt	Payment	Net
Interest to be remitted to B. Inc in \$ $2,00,000 \times 9\% = \$18,000$ Converted into ( $\$18,000 \times \text{¥}120$ )		¥21,60,000	
Interest to be received from B. Inc in \$ converted into ¥ ( $6\% \times \$2,00,000 \times \text{¥}120$ )	¥14,40,000	-	
Interest payable on ¥ loan	-	¥12,00,000	
	¥14,40,000	¥33,60,000	
Net Payment	¥19,20,000	-	
	¥33,60,000	¥33,60,000	
\$ equivalent paid $\text{¥}19,20,000 \times (1/\text{¥}120)$			\$16,000
Interest payable without swap in \$			\$18,000
Opportunity gain in \$			\$ 2,000

**Opportunity gain of B inc under currency swap**

	Receipt	Payment	Net
Interest to be remitted to A. Inc in ( $\$ 2,00,000 \times 6\%$ )		\$12,000	
Interest to be received from A. Inc in ¥ converted into \$ = $\text{¥} 21,60,000 / \text{¥}120$	\$18,000		
Interest payable on \$ loan@10%	-	\$20,000	
	\$18,000	\$32,000	
Net Payment	\$14,000	-	
	\$32,000	\$32,000	

¥ equivalent paid \$14,000 X ¥120			¥16,80,000
Interest payable without swap in ¥ (\$2,00,000 X ¥ 120 X 8%)			<u>¥19,20,000</u>
Opportunity gain in ¥			<u>¥ 2,40,000</u>

**Alternative Solution****Cash Flows of A Inc****(i) At the time of exchange of principal amount**

Transactions		Cash Flows
Borrowings	\$2,00,000 X ¥120	+ ¥240,00,000
Swap		- ¥240,00,000
Swap		<u>+\$2,00,000</u>
Net Amount		<u>+\$2,00,000</u>

**(ii) At the time of exchange of interest amount**

Transactions		Cash Flows
Interest to the lender	¥240,00,000 X 5%	¥12,00,000
Interest Receipt from B Inc.	¥2,00,000 X 120 X 6%	¥14,40,000
Net Saving (in \$)	¥2,40,000/¥120	\$2,000
Interest to B Inc.	\$2,00,000 X 9%	<u>-\$18,000</u>
Net Interest Cost		<u>-\$16,000</u>

A Inc. used \$2,00,000 at the net cost of borrowing of \$16,000 i.e., 8%. If it had not opted for swap agreement the borrowing cost would have been 9%. Thus, there is saving of 1%.

**Cash Flows of B Inc****(i) At the time of exchange of principal amount**

Transactions		Cash Flows
Borrowings		+ \$2,00,000
Swap		- \$2,00,000



Swap	\$2,00,000 X ₹120	<u>+¥240,00,000</u>
Net Amount		<u>+¥240,00,000</u>

**(ii) At the time of exchange of interest amount**

Transactions		Cash Flows
Interest to the lender	\$2,00,000X10%	- \$20,000
Interest Receipt from A Inc.		+\$18,000
Net Saving (in ¥)	-\$2,000X¥120	- ¥2,40,000
Interest to A Inc.	\$2,00,000X6%X¥120	<u>- ¥14,40,000</u>
Net Interest Cost		<u>- ¥16,80,000</u>

B Inc. used ¥240,00,000 at the net cost of borrowing of ¥16,80,000 i.e. 7%. If it had not opted for swap agreement the borrowing cost would have been 8%. Thus, there is saving of 1%.

**10. Working Notes:**

**(I) Decomposition of Funds in Equity and Cash Components**

	D Mutual Fund Ltd.	K Mutual Fund Ltd.
NAV on 31.12.14	₹ 70.71	₹ 62.50
% of Equity	99%	96%
Equity element in NAV	₹ 70	₹ 60
Cash element in NAV	₹ 0.71	₹ 2.50

**(II) Calculation of Beta**

(a) D Mutual Fund Ltd.

$$\text{Sharpe Ratio} = 2 = \frac{E(R) - R_f}{\sigma_D} = \frac{E(R) - R_f}{11.25}$$

$$E(R) - R_f = 22.50$$

$$\text{Treynor Ratio} = 15 = \frac{E(R) - R_f}{\beta_D} = \frac{22.50}{\beta_D}$$

$$\beta_D = 22.50/15 = 1.50$$

(b) K Mutual Fund Ltd.

$$\text{Sharpe Ratio} = 3.3 = \frac{E(R) - R_f}{\sigma_K} = \frac{E(R) - R_f}{5}$$

$$E(R) - R_f = 16.50$$

$$\text{Treynor Ratio} = 15 = \frac{E(R) - R_f}{\beta_K} = \frac{16.50}{\beta_K}$$

$$\beta_K = 16.50/15 = 1.10$$

**(III) Decrease in the Value of Equity**

	D Mutual Fund Ltd.	K Mutual Fund Ltd.
Market goes down by	5.00%	5.00%
Beta	1.50	1.10
Equity component goes down	7.50%	5.50%

**(IV) Balance of Cash after 1 month**

	D Mutual Fund Ltd.	K Mutual Fund Ltd.
Cash in Hand on 31.12.14	₹ 0.71	₹ 2.50
Less: Exp. Per month	₹ 0.25	₹ 0.25
Balance after 1 month	₹ 0.46	₹ 2.25

(i) NAV after 1 month

	D Mutual Fund Ltd.	K Mutual Fund Ltd.
Value of Equity after 1 month		
70 x (1 - 0.075)	₹ 64.75	-
60 x (1 - 0.055)	-	₹ 56.70
Cash Balance	0.46	2.25
	₹ 65.21	₹ 58.95

(ii) Computation to find out more beneficial Mutual fund:

	<b>D Mutual Fund</b>	<b>K Mutual Fund</b>
E(R) - R <sub>F</sub> (a)	22.50	16.50
Risk free rate of return (b)	7	7
Expected Return (a+b) =(c)	29.50	23.50
Standard deviation (d)	11.25	5
Risk per unit Return (d/c)	0.38	0.21

Since risk per unit return of D is more than K, hence investor shall choose K Mutual fund from the perspective of risk per unit of return.

11. (i)

<b>Probability</b>	<b>ABC (%)</b>	<b>XYZ (%)</b>	<b>1X2 (%)</b>	<b>1X3 (%)</b>
(1)	(2)	(3)	(4)	(5)
0.20	12	16	2.40	3.20
0.25	14	10	3.50	2.50
0.25	-7	28	-1.75	7.00
0.30	28	-2	<u>8.40</u>	<u>-0.60</u>
Average return			<u>12.55</u>	<u>12.10</u>

Hence the expected return from ABC = 12.55% and XYZ is 12.10%

<b>Probability</b>	<b>(ABC- ABC)</b>	<b>(ABC- ABC)<sup>2</sup></b>	<b>1X3</b>	<b>(XYZ- XYZ)</b>	<b>(XYZ- XYZ)<sup>2</sup></b>	<b>(1)X(6)</b>
(1)	(2)	(3)	(4)	(5)	(6)	
0.20	-0.55	0.3025	0.06	3.9	15.21	3.04
0.25	1.45	2.1025	0.53	-2.1	4.41	1.10
0.25	-19.55	382.2025	95.55	15.9	252.81	63.20
0.30	15.45	238.7025	<u>71.61</u>	-14.1	198.81	<u>59.64</u>
			<u>167.75</u>			<u>126.98</u>

$$\sigma^2_{ABC} = 167.75(\%)^2; \sigma_{ABC} = 12.95\%$$

$$\sigma^2_{XYZ} = 126.98(\%)^2; \sigma_{XYZ} = 11.27\%$$

- (ii) In order to find risk of portfolio of two shares, the covariance between the two is necessary here.

Probability	(ABC- $\overline{ABC}$ )	(XYZ- $\overline{XYZ}$ )	2X3	1X4
(1)	(2)	(3)	(4)	(5)
0.20	-0.55	3.9	-2.145	-0.43
0.25	1.45	-2.1	-3.045	-0.76
0.25	-19.55	15.9	-310.845	-77.71
0.30	15.45	-14.1	-217.845	<u>-65.35</u>
				<u>-144.25</u>

$$\sigma_p^2 = (0.5^2 \times 167.75) + (0.5^2 \times 126.98) + 2 \times (-144.25) \times 0.5 \times 0.5$$

$$\sigma_p^2 = 41.9375 + 31.745 - 72.125$$

$$\sigma_p^2 = 1.5575 \text{ or } 1.56(\%)$$

$$\sigma_p = \sqrt{1.56} = 1.25\%$$

$$E(R_p) = (0.5 \times 12.55) + (0.5 \times 12.10) = 12.325\%$$

Hence, the return is 12.325% with the risk of 1.25% for the portfolio. Thus, the portfolio results in the reduction of risk by the combination of two shares.

- (iii) For constructing the minimum risk portfolio, the condition to be satisfied is

$$X_{ABC} = \frac{\sigma_X^2 - r_{AX}\sigma_A\sigma_X}{\sigma_A^2 + \sigma_X^2 - 2r_{AX}\sigma_A\sigma_X} \text{ or } = \frac{\sigma_X^2 - \text{Cov}_{AX}}{\sigma_A^2 + \sigma_X^2 - 2\text{Cov}_{AX}}$$

$\sigma_X$  = Std. Deviation of XYZ

$\sigma_A$  = Std. Deviation of ABC

$r_{AX}$  = Coefficient of Correlation between XYZ and ABC

$\text{Cov}_{AX}$  = Covariance between XYZ and ABC.

Therefore,

$$\% \text{ ABC} = \frac{126.98 - (-144.25)}{126.98 + 167.75 - [2 \times (-144.25)]} = \frac{271.23}{583.23} = 0.4650 \text{ or } 46.50\%$$

$$\% \text{ ABC} = 46.50\%,$$

$$\% \text{ XYZ} = (1 - 0.4650) = 0.5350 = 53.50\%$$

$$12. \text{ No. of Shares} = \frac{\text{₹ } 1,300 \text{ crores}}{\text{₹ } 40} = 32.50 \text{ Crores}$$

$$\text{EPS} = \frac{\text{PAT}}{\text{No. of shares}}$$

$$\text{EPS} = \frac{\text{₹ } 290 \text{ crores}}{32.5 \text{ crores}} = \text{₹ } 8.92$$

Calculation of value per share using Free Cash Flow to Equity as basis:

$$\text{FCFE} = \text{Net income} - [(1-b) (\text{capex} - \text{dep}) + (1-b) (\Delta \text{WC})]$$

$$\text{FCFE} = 8.92 - [(1-0.27) (47-39) + (1-0.27) (3.45)]$$

$$= 8.92 - [5.84 + 2.52] = \text{₹ } 0.564$$

$$\text{Cost of Equity } (K_e) = R_f + \beta (R_m - R_f)$$

$$= 8.7 + 0.1 (10.3 - 8.7) = 8.86\%$$

$$P_0 = \frac{\text{FCFE}(1+g)}{K_e - g} = \frac{0.56(1.08)}{0.0886 - 0.08} = \frac{0.6048}{0.0086} = \text{₹ } 70.33$$

**Calculation of value per share using dividend discount model:**

$$P_0 = \frac{D_0(1+g)}{k_e - g} = \frac{2(1.08)}{0.0886 - .08} = \frac{2.16}{0.0086} = \text{₹ } 251.16$$

From the above we can see that value per share on the basis of dividend discount model is more than the value per share on the basis of free cash flow to equity model.

In the dividend discount model, the analyst considers the stream of expected dividends to value the company's stock. It is assumed that the company follows a consistent dividend payout ratio which can be less than the actual cash available with the firm.

A stock's intrinsic value based on the dividend discount model may not represent the fair value for the shareholders because dividends are distributed in the form of cash from profits. In case the company is

maintaining healthy cash in its balance sheet then it means that dividend pay-out is low which could result in undervaluation of the stock.

In the case of free cash flow to equity model a stock is valued on the cash flow available for distribution after all the reinvestment needs of capex and incremental working capital are met. Thus, using the free cash flow to equity model provides a better measure for valuations in comparison to the dividend discount model.

Thus, the view of Mr. Amit that dividend discount model represents the fair value is incorrect. The share is not under-valued rather it is overvalued if we take "free cash flow to equity model" into consideration.

13. To evaluate whether investment in same project is a viable option or not, we shall compute the NPV of the project.

**Working Note:**

- (1) Expected Exchange Rates

End of Year	INR	INR/MUR
1	$\text{INR } 1.88 \times \frac{(1+0.06)}{(1+0.05)}$	1.8979
2	$\text{INR } 1.8979 \times \frac{(1+0.06)}{(1+0.05)}$	1.9160
3	$\text{INR } 1.9160 \times \frac{(1+0.06)}{(1+0.05)}$	1.9342
4	$\text{INR } 1.9342 \times \frac{(1+0.06)}{(1+0.05)}$	1.9526

- (2) Initial Investment = MUR 100 Million x INR 1.88 = INR 18.80 crore  
 Working Capital (Year 1) = MUR 2 Million x 1.8979 = INR 0.3796 crore  
 Working Capital (Year 2) = MUR 2 Million x 1.9160 = INR 0.3832 crore  
 Working Capital (Year 3) = MUR 2 Million x 1.9342 = INR 0.3868 crore  
 Working Capital (Year 4) = MUR 2 Million x 1.9526 = INR 0.3905 crore
- (3) WACC = 40% x 10% + 60% x 12% = 11.20%
- (4) Inflation adjusted Revenue

Year	Revenue (₹)	Revenue (Inflation Adjusted) (₹)
1	6.00 crore	6.00 crore x 1.10 = 6.60 crore
2	7.00 crore	7.00 crore x 1.10 x 1.09 = 8.393 crore
3	8.00 crore	8.00 crore x 1.10 x 1.09 x 1.08 = 10.3594 crore
4	8.00 crore	8.00 crore x 1.10 x 1.09 x 1.08 x 1.07 = 11.0845 crore

(5) Inflation adjusted Cost

Year	Cost (₹)	Cost (Inflation Adjusted) (₹)
1	3.00 crore	3.00 crore x 1.12 = 3.3600 crore
2	4.00 crore	4.00 crore x 1.12 x 1.10 = 4.9280 crore
3	4.00 crore	4.00 crore x 1.12 x 1.10 x 1.09 = 5.3715 crore
4	4.00 crore	4.00 crore x 1.12 x 1.10 x 1.09 x 1.08 = 5.8012 crore

(6) Annual cash flows (₹ Crore)

Year	1	2	3	4
Revenue	6.600	8.393	10.3594	11.0845
Less: Cost	3.360	4.928	5.3715	5.8012
Less: Depreciation	1.800	1.800	1.800	1.800
Profit before Tax (PBT)	1.440	1.665	3.1879	3.4833
Tax @ 30%	0.432	0.4995	0.9564	1.0450
Profit after Tax	1.008	1.1655	2.2315	2.4383
Add: Depreciation	1.800	1.800	1.800	1.800
Cash Flows	2.808	2.9655	4.0315	4.2383

#### NPV of the Project

Year	0	1	2	3	4
Initial Investment (₹ Crore)	(18.80)				

Working Capital (₹ Crore)	-	(0.3796)	(0.3832)	(0.3868)	(0.3905)
Scrap Value (₹ Crore)					0.8000
W.C Recovered (₹ Crore)					1.5401
Annual Cash flows		2.8080	2.9655	4.0315	4.2383
Net Cash Flow	(18.80)	2.4284	2.5823	3.6447	6.1879
Exchange Rate	1.88	1.8979	1.9160	1.9342	1.9526
Cash Flows (in Million MUR)	(100)	12.7952	13.4776	18.8434	31.6906
PVF@11.20%	1	0.8993	0.8087	0.7273	0.6540
Present value (in Million MUR)	(100)	11.5067	10.8993	13.7048	20.7257

Net Present Value = - MUR 43.1635 Million

**Advise:** Since NPV of the project is negative the proposal is not a viable option for investment.

14. Succession planning is the process of identifying the critical positions within an organization and developing action plans for individuals to assume those positions. A succession plan identifies future need of people with the skills and potential to perform leadership roles.

Taking a holistic view of current and future goals, this type of preparation ensures that the right people are available for the right jobs today and in the years to come. It can also provide a liquidity event, which enables the transfer of ownership in a going concern to rising employees.

**Need for succession planning can be explained below:**

- ❖ **Risk mitigation** – If existing leader quits, then searches can take six-nine months for suitable candidate to close. Keeping an organization without leader can invite disruption, uncertainty, conflict and endangers future competitiveness.
- ❖ **Cause removal** – If the existing leader is culpable of gross negligence, fraud, wilful misconduct, or material breach while discharging duties and has been barred from undertaking further



activities by court, arbitral tribunal, management, stakeholders or any other agency.

- ❖ **Talent pipeline** – Succession planning keep employees motivated and determined as it can help them obtaining more visibility around career paths expected, which would help in retaining the knowledge bank created by company over a period of time and leverage upon the same.
- ❖ **Conflict Resolution Mechanism** – This planning is very helpful in promoting open and transparent communication and settlement of conflicts.
- ❖ **Aligning** – In family owned business succession planning helps to align with the culture, vision, direction and values of the business.

15. Traditionally, the main role of CFO was concentrated to wealth maximisation for shareholders by taking care of financial health of an organization and overseeing and implementing adequate financial controls.

However, in recent time because of globalization, growth in information and communications, pandemic situation etc. their range of responsibilities has been drastically expanded, driven by complexity, and changing expectations.

Now a days in addition to fulfilling traditional role relating to governance, compliances and controls, and business ethics as a part of the leadership of role CFOs are also expected to contribute their support in strategic and operational decision making.

In post-pandemic time their role has been advanced in the following areas in addition to traditional role:

- a. **Risk Management:** Now a days the CFOs are expected to look after the overall functioning of the framework of Risk Management system of an organisation.
- b. **Supply Chain:** Post pandemic supply chain management system has been posing the challenge for the company to maintain the sustainable growth. Since CFOs are care takers of finance of the company, considering the financial viability of the Supply Chain Management their role has now become more critical.

- c. **Mergers, acquisitions, and Corporate Restructuring:** Since in recent period to maintain the growth and capture the market share there has been a spate of Mergers and Acquisitions and hence the role of CFOs has become more crucial because these are strategic decision and any error in them can lead to collapse of the whole business.
- d. **Environmental, Social and Governance (ESG) Financing:** With the evolving of the concept of ESG their role has been shifted from traditional financing to sustainability financing.

Thus, from above discussion it can be concluded that in today's time CFOs are taking a leadership role in Value Creation for the organisation and that too on sustainable basis for a longer period.



## PAPER – 3: ADVANCED AUDITING, ASSURANCE AND PROFESSIONAL ETHICS



### QUESTIONS

#### PART A: Multiple Choice Questions

##### Integrated Case Scenario 1.

Mr. Ayush, the proprietor of BCD & Co Chartered Accountants, was appointed to audit the financial statements of Amrita Industries Private Limited for the Financial Year 2022-23. These financial statements were prepared in accordance with the Dutch GAAP and the terms & conditions specified in the contract between Amrita Industries Private Limited and Dutch Industries b.v. (Pvt. Ltd is known as b.v. in Dutch). One of the terms and conditions of the contract was to get the financial statements audited from an independent auditor. The contract also stipulated auditors to take into account misstatements of € 5000 or more while framing their report. Any misstatements identified below this threshold did not require correction or adjustment in terms of stipulation in contract. While planning audit, the audit team had also determined performance materiality at € 10000 and overall materiality at € 200000.

The following information extracted from general purpose financial statements of Amrita Industries Pvt. Ltd. prepared in accordance with provisions of the Companies Act, 2013 is given as under: -

(Figures in ₹ crores)

Particulars	FY 22-23	FY 21-22
Turnover	300	250
Borrowings from bank	100	75
Paid up capital	25	25

The borrowings from bank consisted of working capital credit facilities only. The company had been enjoying such credit facilities with a sanctioned amount of ₹75 crore in Financial Year 21-22. The credit facilities were enhanced to ₹ 100 crore at beginning of Financial Year 22-23. Outstanding balance in above credit facilities has never crossed sanctioned limits at any time during each of the above years.

Mr. Shubham, partner at BB & Associates, Chartered Accountants firm, was appointed as engagement partner for audit of general-purpose financial statements of Amrita Industries Private Limited for FY 2022-23. Before finalising audit plan, BB & Associates asked for internal audit reports. However, management informed him that there was no internal audit team or function in the organization.

During the course of audit of general-purpose financial statements, Mr. Anand, an audit executive performed risk assessment procedures, test of controls and substantive procedures. He performed a trend analysis to compare the purchases of raw materials in various months. He also performed purchase–production–sale cycle analysis to understand inventory holding. Besides going through the company's internal control manuals and visiting company's plant, inquiries were also made with company's information system personnel to provide information about control failures. Diligent inquiries were also made from company's marketing personnel regarding contractual arrangements with customers. Inquiries were also made from company's in-house legal counsel and communications were also made with company's external legal counsel by sending a letter of inquiry.

While issuing the report, BCD & Co inserted an Other Matter Paragraph in the Audit Report specifying the use of a special purpose financial reporting framework for preparing and presenting the financial statements. On the other hand, BB & Associates decided to issue an adverse opinion on all financial statement except for cash flow statement and an unmodified opinion on cash flow statement. As per BB & Associates, the cash flow statement was prepared as per the required method, and hence, it did reflect the appropriate figures.

**On the basis of the abovementioned facts, you are required to answer the following MCQs:**

1. The audit team of BCD & Co were not sure which materiality to choose to evaluate the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements in order to form an opinion and to conclude as to whether the auditor has obtained reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. You are required to guide the audit team by selecting the appropriate option from below:
  - (a) In the case of special purpose financial statements, management may agree with the intended users on a threshold below which misstatements identified during the audit will not be corrected or otherwise adjusted. The existence of such a threshold does not relieve the auditor from the requirement to determine materiality in accordance with SA 320 for purposes of planning and performing the audit of the special purpose financial statements.
  - (b) In the case of special purpose financial statements, management may agree with the intended users on a threshold below which misstatements identified during the audit will not be corrected or otherwise adjusted. The existence of such a threshold is sufficient to comply with the requirement of determining materiality in accordance with SA 320 for purposes of planning and performing the audit of the special purpose financial statements.
  - (c) In the case of special purpose financial statements, misstatements based on consideration of the financial information needs of the intended users are considered material and pervasive. However, the auditor needs to follow the threshold limit provided in terms of the contract, and such thresholds should be considered as the performance materiality for planning and performing the audit.
  - (d) The auditor is required to comply with each requirement of an SA unless, in the circumstances of the audit, the entire SA is not relevant, or the requirement is not relevant because it is conditional and the condition does not exist. In the case of an audit of special purpose

financial statements, the requirements of SA 320 are not applicable in entirety.

2. Mr. Manish, the audit manager of BCD & Co., objected to the insertion of the Other Matter Paragraph in the audit report. According to him, there is no such requirement to insert Other Matter Paragraph to disclose the use of a Special Purpose Framework. Whether contention of Mr. Manish is in order?
  - (a) The auditor's report on special purpose financial statements shall include an Other Matter paragraph alerting users of the auditor's report that the financial statements are prepared in accordance with a special purpose framework and that, as a result, the financial statements may not be suitable for another purpose.
  - (b) To avoid misunderstandings, the auditor shall mention that the financial statements are prepared in accordance with a special purpose framework and, therefore, may not be suitable for another purpose in Management's Responsibility section. Adding an Other Matter Paragraph for this will result in duplication of the matter, and the same should be avoided.
  - (c) The auditor may consider it appropriate to indicate that the auditor's report is intended solely for the specific users and may not be suitable for another purpose by adding a Key Audit Matter in the Key Audit Matter Paragraph.
  - (d) The auditor's report on special purpose financial statements shall include an Emphasis of Matter paragraph alerting users of the auditor's report that the financial statements are prepared in accordance with a special purpose framework and that, as a result, the financial statements may not be suitable for another purpose.
3. Mr. Chitrang, the audit manager at BB & Associates Chartered Accountant, is seeking your guidance in drafting separate opinions on the cash flow statement and Other Financial Statements. Guide the audit manager by selecting the appropriate option from below:
  - (a) When the auditor considers it necessary to express an adverse opinion or disclaim an opinion on the financial statements as a whole, the auditor's report shall not include an unmodified opinion

- with respect to the same financial reporting framework on a single financial statement or one or more specific elements, accounts or items of a financial statement.
- (b) The expression of a disclaimer of opinion regarding the results of operations, and cash flows, where relevant, and an unmodified opinion regarding the financial position is allowed. In this case, the auditor has expressed a disclaimer of opinion on the financial statements as a whole and separate opinion on cash flows.
  - (c) The expression of an unmodified opinion on financial statements prepared under a given financial reporting framework and, within the same report, the expression of an adverse opinion on the same financial statements under the same financial reporting framework is permissible.
  - (d) An adverse opinion or a disclaimer of opinion relating to a specific matter described within the Basis for Opinion section does not limit the auditor's responsibility to issue an unmodified opinion on identified matters that would not require a modification of the auditor's opinion.
4. The company has violated provisions of the Companies Act, 2013 by not appointing an internal auditor. Which of following statement is likely to be correct reason necessitating appointment of internal auditor and for matters relating to appointment of internal auditor for the financial year 2022-23 in described situation in accordance with provisions of law?
- (a) The company was required to appoint internal auditor during financial year 2022-23 as it fulfilled necessary condition relating to turnover during financial year 2021-22. Such an internal auditor may have been either an individual or a partnership firm only.
  - (b) The company was required to appoint internal auditor during financial year 2022-23 as it fulfilled all necessary conditions relating to turnover, borrowings from banks and paid up capital during financial year 2022-23. Such an internal auditor may have been either an individual, a partnership firm or a body corporate.

- (c) The company was required to appoint internal auditor during financial year 2022-23 as it fulfilled necessary condition relating to turnover during financial year 2021-22. Such an internal auditor may have been either an individual, a partnership firm or a body corporate.
  - (d) The company was required to appoint internal auditor during financial year 2022-23 as it fulfilled necessary conditions relating to turnover and borrowings from banks during financial year 2022-23. Such an internal auditor may have been either an individual or a partnership firm.
5. Mr. Anand, an audit executive, has performed various procedures during the course of audit. Which of the following procedure/combinations of procedures is/are not likely to be considered as risk assessment procedures?
- (a) Performing trend analysis, going through company's internal control manuals and visiting company's plant
  - (b) Inquiries from company's marketing personnel and with in-house legal counsel
  - (c) Communication with company's external legal counsel by sending a letter of inquiry
  - (d) Inquiries made with company's information system personnel to provide information about control failures and going through company's internal control manuals

**Independent MCQs**

6. Safe Health Insurance Limited is a company working in the field of health insurance sector. It is now using a claim management system where incoming claims can be immediately identified on the website itself. A form is issued to the customer who signs it. The details are verified by the system against data present in it. Such system has allowed faster processing of claims, error-free data validation and increased customer satisfaction.

In respect of situation regarding working of insurance company in health insurance sector, which of following technologies has likely been used?



- (a) Internet of things
- (b) Data analytics
- (c) Robotic process automation
- (d) Power BI

7. Bansal Arora & Co., a Chartered Accountants firm, is currently performing an audit for Wool Ltd., a sizable manufacturing company. Mr. Bhavesh Bansal, an experienced audit engagement partner, holds the responsibility of ensuring that the audit engagement aligns with the professional standards, adheres to regulatory requirements, and complies with the legal obligations. His duties encompass the overall supervision, direction, and the final issuance of the audit report.

While conducting the audit, the engagement team encounters a complex issue pertaining to the valuation of the company's inventory. Within the team, there are difference of opinions on how to address this matter, resulting in a contentious situation.

What is Mr. Bhavesh's responsibility in this situation?

- (a) Mr. Bhavesh shall adhere to the firm's policies only for addressing and resolving differences of opinion.
  - (b) Mr. Bhavesh should secure management's representation concerning the valuation and proceed with further audit procedures.
  - (c) Mr. Bhavesh should ensure that appropriate consultation occurs within the engagement team and, if necessary, with individuals at an appropriate level within or outside the firm.
  - (d) Mr. Bhavesh should communicate the issue to the client's management for resolution.
8. ALEXA Private Limited has been operating in India for the past 15 years with three group companies – one subsidiary in India and the other two in Singapore and Germany. The acquisitions of these subsidiaries were gradual, with control obtained after initial investments. The statutory auditors have determined that all group companies are significant for the audit of consolidated financial statements. For the year ending

March 31, 2023, the audited financial statements of all components are available, except for the German company, whose audit has been delayed and won't be completed before the release date of the consolidated financial statements (CFS) of the parent company.

The financial statements of the German company for the consolidation audit of CFS, what could be the possible situation?

- (a) Since the audit of the German company is in progress, its financial statements subject to audit can be considered by the auditor of the parent company. Audited and signed financials can be provided to auditors even after the release of audited CFS, as this is a matter of documentation only.
- (b) If the auditor does not receive audited financial statements of the German company, he should modify his audit report.
- (c) The management should provide management accounts to the auditors of CFS, and the auditor can mention this point in the "other matters" paragraph in his audit report, which is an acceptable approach.
- (d) The auditor should exclude the financial statements of the German company from the CFS.

## **PART B: DESCRIPTIVE QUESTIONS**

### **Standards on Auditing, Statements and Guidance Notes**

#### **General Auditing Principles and Reporting**

9. While conducting the audit of Quantum Mechanics Limited, Mr. Manoj, the audit manager, identified significant payments made by the company for legal and retainership fees related to litigation. The litigation pertained to the Thirunelly manufacturing plant, situated on forest land reserved for the Elephant Corridor, which was declared illegally constructed. The company had received a notice to decommission the plant by 31-05-2022, but it had challenged decommissioning order in the High Court and matter was still pending there. The company had not disclosed any information related to the litigation in its financial statements for Financial Year 2022-23. The Thirunelly plant accounted for over 75% of the company's annual

production, and the audit team expressed concerns that decommissioning could significantly disrupt operations and potentially lead to bankruptcy.

The audit was near to completion. When Mr. Manoj sought advice from audit partner Mr. Shalabh on this matter, he suggested that no immediate action was necessary from the auditors, as the matter was still pending in Kerala High Court.

However, Mr. Manoj feels that situation requires action from auditors and to be indicated in the report. Whose view seems to be appropriate? Comment with reference to applicable Standards on Auditing.

10. You are appointed as Statutory Auditor of Supreme Ltd. and are in the midst of conducting Annual Audit for the financial year ending on 31<sup>st</sup> March, 2023. During the course of audit, you come across a situation involving recording of purchases amounting to ₹ 1.50 crores from a company incorporated on 18<sup>th</sup> March, 2023. Upon further inquiry, you discover that purchases have been booked at the instance of one of the directors. Further, despite this entry in books, no payment was made and there is lack of documentary or other evidence validating these purported purchases. How would you deal in the given situation?

**Materiality, Risk assessment and Internal Control**

11. While assessing the impact of uncorrected misstatements in the audit of Manhattan Constructions Private Limited, Mr. Sushil encountered a significant issue related to the calculation of materiality on Sales. The initial materiality calculation was based on estimated figures provided by the management. Notably, during the estimation of full-year sales, the management extrapolated from the actual amount of 11 months to derive the 12 months of sales. However, given the nature of Manhattan Constructions as a company in the construction sector, where monthly sales exhibit substantial variations, a unique challenge emerged.

The actual sales for the last month deviated significantly from the estimated sales due to an unforeseen increase in stamp duty rates imposed by the government in that region. As a result, the last month's actual sales represented only 25% of the estimated sales. Now, Mr. Sushil is confronted with a dilemma regarding the appropriate approach

to evaluate uncorrected misstatements using the previously calculated materiality. Kindly Guide Mr. Sushil in the light of relevant Standards on Auditing.

### Related Services

12. Brown Enterprises Limited has huge funds locked up in its trade receivables standing at around ₹ 100 crores as on 31<sup>st</sup> December, 2023. The management of the company wants to evaluate validity of the trade receivables to ensure reliability of financial reporting at the year end. The accounts department has provided a list of trade receivables to the management containing about 1000 names, their balances and contact/communication details spread in different parts of the country. The company's management has requested CA. Karuna to take up this assignment and prepare a report for management in accordance with professional standards. Despite not being statutory auditor of the company, she decides to accept above engagement.
- (a) By explaining nature of engagement described above, discuss whether it was proper for her to accept such engagement.
- (b) While reporting, which precautions should be taken by her so that readers of the report do not misunderstand its scope?

### Prospective Financial Information and Other Assurance Services

13. STAR Limited has outsourced its payroll processing functions to a service organization - Little Solutions Private Limited. Little Solutions Private Limited is responsible for accurate preparation of payrolls and timely remittance of statutory dues to the government authorities on behalf of the company. Little Solution Private Limited's controls related to timely remittance of payroll deductions to government authorities are relevant to the company as late remittances could result in interest and penalties resulting in liabilities for the company.

The auditors of STAR Limited want to be sure about description, design and operating effectiveness of controls at Little Solutions throughout the year. In this regard, they require an assurance report from auditors of Little Solutions Private Limited.

- (a) Why the auditors of STAR Limited require an assurance report from the auditors of Little Solutions Private Limited? Which engagement and quality control standard casts such kind of responsibility upon the auditor?
- (b) Which type of report should be provided by the auditors of Little Solutions? Justify with reasons.
- (c) State matters on which opinion is to be provided by the auditors of Little Solutions.

**Digital Auditing and Assurance**

14. Certain studies have suggested that increase in cyber-attacks and rise in global payment processing cost have hit global banking and finance industries enormously. Therefore, such industries are going to place reliance on new technologies such as Blockchain. Blockchain is based on a decentralized and distributed ledger that is secured through encryption. Each transaction is validated by the blockchain participants, creating a block of information that is replicated and distributed to all participants. However, such technology comes with its weaknesses and associated risks.

What are common risks for Blockchain technology? Also discuss probable audit implications where such technology can be used.

**Special Features of Audit of Banks and Non-Banking Financial Companies**

15. PDSJ & Associates are Statutory Auditors of a scheduled Commercial Bank for the year 2023-24. While evaluating internal control over advances, it came to their notice that classification of term loan borrower accounts into SMA as well as NPA is done in the system on the following lines:
- In case full dues are not received on a particular due date, a borrower account is immediately considered as overdue on the very next day. For example, if due date of loan account is 31st March, 2023 and dues are not received on 31st March, 2023, it shall be considered as overdue on 1st April, 2023.
  - If it continues to remain overdue, then account is tagged as SMA-1 on 1st May, 2023.

- If it continues to remain overdue further, then account is tagged as SMA-2 on 31st May, 2023.
- If it continues to remain overdue even after being tagged as SMA-2, it is classified as NPA on 30th June, 2023.

Evaluate above control designed by bank in the system for the purpose of exercising control over such advances in compliance to regulatory guidelines.

#### **Audit of Public Sector Undertakings**

16. Comptroller & Auditor General appointed Saha & Associates, a Chartered Accountant firm, to conduct Performance audit of herbal Ltd., a public sector undertaking of Government of India. The firm conducted the audit with a view to check that all the expenses of the unit are in conformity with the public interest and publicly accepted customs. The audit report submitted by the audit firm was rejected by C&AG. Give your opinion on the action of C&AG.

#### **Internal Audit**

17. CA. Sanjana has recently joined as Chief Internal Auditor of Up Scale Limited, a listed company. Her subordinate staff in internal audit department brings to her knowledge many prior audit issues highlighted in the previous internal audit reports which are still open. Does she have any responsibilities in this regard? How should she proceed in this situation?

#### **Sustainable Development Goals (SDG) & Environment, Social and Governance (ESG) Assurance**

18. SEBI has made Business Responsibility and Sustainability Report (BRSR) mandatory for certain listed companies. It is an evolutionary step in Environment, Social and Governance (ESG) reporting. Discuss the nature of ESG reporting. How can corporates contribute to Sustainable Development Goals (SDGs)?

**Professional Ethics & Liabilities of Auditors**

19. (a) Comment on the following with reference to the provisions of the Chartered Accountant Act 1949:
- (1) CA. Pankaj accepted professional work of acting as valuer under direct taxes. He charges fees on a percentage of the property valued.
  - (2) CA. Anita joined as an audit executive in a CA firm on April 1, 2023. Despite receiving multiple reminders from ICAI, she has failed to respond with her appointment date and submit her membership certificate.
- (b) Mr. Johny, a chartered accountant, was invited to a seminar on bank audits to give a presentation on the process of conducting such audits. During his presentation, he provided examples from his clients' experiences and shared the significant information about clients with the intention of aid in understanding of audience on the topic. Does above situation have implications in relation to the professional ethics?
20. CA. Tanya, the auditor of KBC Pvt. Ltd. has delegated following works to his articles and staff:
- i. Issue of audit queries during the course of audit.
  - ii. Issue of memorandum of cash verification and other physical verification.
  - iii. Letter forwarding draft observations/financial statements.
  - iv. Issuing acknowledgements for records produced.
  - v. Signing financial statements of the company.
- Is this correct as per the Professional Ethics and ICAI's guidelines and pronouncements?

**SUGGESTED ANSWERS/HINTS****PART A: Answers to Multiple Choice Questions**

1. (a)
2. (d)
3. (a)
4. (c)
5. (c)
6. (c)
7. (c)
8. (b)

**PART B: Answers to Descriptive Questions**

9. In accordance with SA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements", if the auditor concludes that the non-compliance has a material effect on the financial statements and has not been adequately reflected in the financial statements, the auditor shall in accordance with SA 705, "Modifications to the Opinion in the Independent Auditor's Report", express a qualified or adverse opinion on the financial statements.

In the specific case of Quantum Mechanics Limited, where significant legal and retainership fees have been paid related to a lawsuit concerning the Thirunelly manufacturing plant, the auditor needs to assess the impact of non-compliance on the financial statements. Given that the Thirunelly plant constitutes over 75% of the company's annual production and the audit team believes that decommissioning the plant could potentially lead to bankruptcy, the non-disclosure of such a significant matter would have a material and pervasive impact on the financial statements.

Contrary to the audit partner's suggestion that no action is necessary as the matter is pending in the Kerala High Court, the requirements of SA 250 and SA 705 necessitate a different approach. The auditor should



express either a qualified or an adverse opinion on the financial statements based on the level of impact of non-disclosure. Further, above situation involves pending legal or regulatory proceedings against the entity that may, if successful, result in claims that the entity may not be able to satisfy. It is an example of events or conditions that may cast a significant doubt on entity's ability to continue as a going concern. However, no disclosure is made in financial statements about the material uncertainty. SA 570, "Going Concern" also mandates auditor to express a qualified or an adverse opinion in accordance with SA 705, if adequate disclosure is not made about material uncertainty in financial statements. As a non-disclosure of such a significant matter would have material and pervasive impact of financial statements, adverse opinion in this situation appears appropriate. Therefore, Mr. Manoj's view seems to be proper.

- 10.** SA 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements," emphasize that fraud can be perpetrated by management override of controls, such as the creation of fictitious journal entries, particularly towards the end of an accounting period, to manipulate operating results or achieve specific objectives.

In the case of Supreme Ltd., where purchases of ₹ 1.50 crore were recorded at year-end without supporting evidence, it became apparent during the investigation that the company had entered fictitious journal entries to manipulate the operating results.

Given this situation, the auditor would align their approach based on the impact of the misstatement resulting from such fictitious journal entries. If, due to fraud or suspected fraud, the auditor encounters exceptional circumstances that cast doubt on their ability to continue the audit, they must assess the professional and legal responsibilities applicable. This includes considering reporting obligations to those who appointed the auditor or, in some cases, to regulatory authorities. The appropriateness of withdrawal from the engagement is also a consideration, where legally permitted.

Furthermore, the auditor is mandated to report in accordance with Section 143(12) of the Companies Act, 2013. According to Section 143(12) read with Rule 13 of Companies (Audit & Auditor's) Rules, 2014,

if the auditor, during the performance of their duties, has reason to believe that an offence of fraud involving an amount of ₹1 crore or more has been committed by the company's officers or employees, reporting to the Central Government is required in the prescribed manner.

Additionally, reporting obligations extend to Clause (xi) of Paragraph 3 of Companies (Auditor's Report) Order, 2020. The auditor is obligated to disclose whether any fraud by the company or against the company by its officers or employees has been observed or reported during the year. If affirmative, the nature and amount involved are to be indicated. This comprehensive reporting framework ensures transparency, adherence to legal requirements, and protection of stakeholders' interests in the face of potential fraudulent activities.

11. As per SA 450 "Evaluation of Misstatements Identified during the Audit", the auditor is required to reassess materiality, in accordance with SA 320 "Materiality in Planning and Performing an Audit", before evaluating the impact of uncorrected misstatements. This reassessment is crucial to confirm the ongoing appropriateness of materiality in light of the entity's actual financial results.

The determination of materiality under SA 320 often relies on estimates of the entity's financial results, given that the actual results may not be known during the early stages of the audit. Therefore, before the auditor proceeds to assess the effect of uncorrected misstatements, it becomes necessary to adjust the materiality calculated under SA 320 based on the now available actual financial results.

SA 320 outlines that, as the audit progresses, materiality may be revised for the financial statements as a whole or for specific classes of transactions, account balances, or disclosures. This revision is prompted by the auditor's awareness of information that would have led to a different initial determination. Typically, significant revisions occur before the evaluation of uncorrected misstatements. However, if the reassessment of materiality under SA 320 results in a lower amount, the auditor must reconsider performance materiality and the appropriateness of the audit procedures' nature, timing, and extent. This is crucial for obtaining sufficient and appropriate audit evidence on which to base the audit opinion.

In the present case involving Manhattan Constructions Private Limited, it has been identified that the materiality calculated at the beginning of the audit for Sales was based on estimates provided by the management. The management extrapolated sales for the full year using the actual amount of 11 months, but since the company experiences significant monthly variations in sales, the actual sales for the last month were only 25% of the estimated figure. This discrepancy arose due to an unexpected increase in stamp duty rates by the government in that region.

In this audit scenario, Mr. Sushil, the auditor, must review and re-assess the materiality initially determined under SA 320 to ensure its continued validity in light of the actual financial results. If the re-assessed materiality is lower than the previously calculated amount, Mr. Sushil must reconsider performance materiality and the appropriateness of the nature, timing, and extent of further audit procedures. This meticulous approach is essential to gather sufficient and appropriate audit evidence, enabling Mr. Sushil to form an independent and objective opinion on the financial statements of Manhattan Constructions Private Limited.

- 12. (a)** The above situation involves an engagement to perform agreed-upon procedures. In such an engagement, the auditor is engaged by the client to issue a report of factual findings based on specified procedures performed on specified subject matter of specified elements, accounts or items of a financial statement.

The management has requested CA. Karuna to take up the assignment and prepare report for management in accordance with professional standards. Such type of engagement and its reporting falls in purview of SRS 4400. The reference to auditor in SRS 4400 does not imply that a person performing related services need necessarily be the auditor of entity's financial statements. Hence, a person performing related services need not necessarily be auditor of entity's financial statements. Therefore, it was proper for CA. Karuna to accept above engagement.

**(b)** While reporting, she should take following precautions so that readers of report do not misunderstand its scope: -

- A statement that the procedures performed do not constitute either an audit or a review and, as such, no assurance is expressed.
- A statement that, had the auditor performed additional procedures, an audit or a review, other matters might have come to light that would have been reported.
- A statement that the report is restricted to those parties that have agreed to the procedures to be performed.
- A statement (when applicable) that the report relates only to the elements, accounts, items or financial and non-financial information specified and that it does not extend to the entity's financial statements taken as a whole.

**13.** When the user entity uses the services of a service organisation, objectives of auditor of user entity are:

- (a)** To obtain an understanding of the nature and significance of the services provided by the service organisation and their effect on the user entity's internal control relevant to the audit, sufficient to identify and assess the risks of material misstatement and
- (b)** To design and perform audit procedures responsive to those risks.

Therefore, it is in line with above requirements, that auditors of STAR Limited require an assurance report from auditors of Little Solutions Private Limited. SA 402 casts such responsibility on user auditors.

In accordance with requirements of SAE 3402, auditors of Little Solutions Private Limited should provide a type 2 report to auditors of STAR Limited. As auditors of STAR Limited want to be sure about description, design and operating effectiveness of controls at Little Solutions Pvt. Ltd. throughout the year and type 2 report deals with such matters, type 2 report should be provided by the auditors of the Little Solutions Pvt. Ltd. Type 2 report is a report on the description, design and operating effectiveness of

controls at a service organization whereas type 1 report is a report on the description and design of controls at a service organization.

- (c) The opinion of auditors of Little Solutions Pvt. Ltd. would state whether, in all material respects, based on suitable criteria: -
- The description fairly presents the service organization's system that had been designed and implemented throughout the specified period;
  - The controls related to the control objectives stated in the service organization's description of its system were suitably designed throughout the specified period and
  - The controls tested, which were those necessary to provide reasonable assurance that the control objectives stated in the description were achieved, operated effectively throughout the specified period.

14. The strengths of blockchain can also be its weaknesses. The inability to reverse transactions and to access data without the required keys make the system secure but also means that organisations need specific protocols and management processes to ensure that they are not locked out and have clear contingency plans. Operating through network nodes could also expose the organisation to cyber-attacks and data hacks, so security issues are important.

Auditors should consider the appropriate governance and security around the transactions. Although blockchain's core security premise rests on cryptography, there are risk factors associated with it. As blockchain interacts with legacy systems and business partners, concerns related to insecure application programming interfaces (APIs), data confidentiality and privacy cannot be ignored. Weak blockchain application development protocols are something auditors cannot overlook. Similarly, data privacy laws and regulations may be an area of concern as data are communicated across geographic boundaries. Auditors must be able to determine whether the data put on blockchain will expose the enterprise for non-compliance with applicable laws and regulations.

Auditors should also ensure that the organisation has the necessary data management processes which complies with regulations. The regulatory landscape is still evolving for blockchain so audit teams should check that compliance managers are following developments constantly and adapting processes accordingly.

- 15.** The design of above control instituted by bank in its system is not in accordance with the regulatory guidelines. Any amount due to the bank under any credit facility is 'overdue' if it is not paid on the due date which is fixed by the bank, the borrower accounts are flagged as overdue by the banks as part of their day-end processes for the due date.

Classification of borrower accounts as SMA as well as NPA is done as part of day-end process for the relevant date. SMA or NPA classification date is the calendar date for which the day end process is run. In other words, the date of SMA/NPA reflects the asset classification status of an account at the day-end of that calendar date.

In the given situation, due date of a loan account is March 31, 2023, and full dues are not received by the bank before it runs the day-end process for this date, the date of overdue shall be March 31, 2023 and not 1st April, 2023.

If it continues to remain overdue, then this account shall get tagged as SMA-1 upon running day-end process on April 30, 2023 [i.e. upon completion of 30 days of being continuously overdue]. Accordingly, the date of SMA-1 classification for that account shall be April 30, 2023.

Similarly, if the account continues to remain overdue, it shall get tagged as SMA-2 upon running day-end process on May 30, 2023 and if continues to remain overdue further, it shall get classified as NPA upon running day-end process on June 29, 2023.

- 16.** In the provided scenario, Saha & Associates, a Chartered Accountant firm, was appointed by the Comptroller and Auditor General (C&AG) to conduct a Performance Audit of Herbal Ltd., a Public Sector Undertaking (PSU) of the Government of India. The audit, however, primarily focused on verifying that all expenses of the unit were in conformity with public

interest and publicly accepted customs, which does not align with the essence of a Performance Audit.

A Performance Audit is characterized as an impartial and systematic examination of evidence aimed at providing an independent assessment of the performance of a government organization, program, activity, or function. The ultimate goal is to furnish information that enhances public accountability and aids decision-making by entities responsible for oversight or corrective action.

In the context of PSUs, Performance Audits are conducted by the C&AG, specifically through various subordinate offices of the Indian Audit and Accounts Department (IAAD). The auditing process adheres to manuals and standards set by the C&AG, guiding subordinate offices in evaluating the economy, efficiency, and effectiveness of policies, programs, organizations, and management.

The objectives of Performance Auditing encompass promoting accountability by aiding governance and oversight bodies in enhancing performance and fostering transparency by providing insights into the management and outcomes of diverse government activities. The focus is on areas where adding value holds the greatest potential for development, thereby encouraging responsible parties to take appropriate actions.

The Regulations on Audit and Accounts issued by C&AG outline that the responsibility for developing measurable objectives, performance indicators, and measurement systems rests with Government departments or Heads of entities. They are further required to define intermediate and final outputs and outcomes in measurable and monitorable terms, standardize unit delivery costs, and benchmark the quality of outputs and outcomes.

Therefore, the rejection of the audit report submitted by Saha & Associates by the C&AG is warranted. This is because the audit conducted by the firm, which primarily aimed at checking the conformity of expenses to public interest and accepted customs, does not align with the comprehensive nature of Performance Audits, which evaluate various aspects of economy, efficiency, and effectiveness.

17. In the given situation, CA. Sanjana has recently joined as Chief Internal Auditor in Up Scale Limited, a listed company. As a Chief Internal Auditor, CA. Sanjana is responsible for continuously monitoring the closure of prior audit issues through timely implementation of action plans included in past audits. This shall be done with a formal monitoring process, elements of which are pre-agreed with management and those charged with governance. The responsibility to implement the action plans remains with the management. In monitoring and reporting of prior audit issues, the responsibility of the CA. Sanjana as internal auditor is usually in the form of an "Action Taken Report (ATR) of previous audits". The term "Monitoring and Reporting" refers to the periodic tracking of issues raised during prior audits and evaluation of the corrective actions undertaken by the auditee to resolve them and to report any open and pending matters to the management and those charged with governance.

CA. Sanjana should review whether follow-up action is taken by the management on the basis of his report. If no action is taken within a reasonable time, she should draw the management's attention to it. Where the management has not acted upon the suggestions or not implemented the prescribed recommendations, she should ascertain the reasons thereof.

Where the management has accepted recommendations of the CA. Sanjana and initiated the necessary action, she should periodically review the manner and the extent of implementation of the recommendations and report to the management highlighting the recommendations which have not been implemented fully or partly.

18. Environment, Social and Governance (ESG) reporting is all about disclosure of information, data, metrics that explain the added value in following three areas:

**Environment**

Environmental stands for corporate climate policies, energy use, waste, pollutions, natural resource conservation, and treatment of animals. It includes the natural resources that every entity absorbs for its functioning like that of coal, electricity, water and so on. Processing this



energy into products / services which will leave behind certain wastes like that of carbon emissions, water discharges, e-wastes and so on. Thus, one is dependent on the environment for carrying out its operations.

**Social**

It addresses the relationships the entity has and the reputation it fosters with people and institutions in the communities where you do business and the value chain involved. It further includes labour relations, diversity, and inclusions. Every company operates within a broader and diverse society.

**Governance**

It is the internal system of practices, controls, and procedures entity adopts in order to govern itself, make effective investment decisions, comply with the law, and meet the needs of all stakeholders. Every entity, which is itself a legal creation, requires governance.

ESG reporting can be both quantitative and qualitative in nature. Qualitative reports tend to describe a company's strategy or policy around the relevant topics, while a quantitative approach includes metrics, and key performance indicators (KPIs) linked to each area in order to measure progress against goals and report on achievements. Naturally, a mixed approach that makes use of both qualitative and quantitative information tends to add the maximum value to the quality of disclosures.

United Nations members states adopted Sustainable Development to provide a blueprint which mentioned the Sustainable Development Goals (SDGs). They recognized that ending poverty and other deprivations must go hand in hand with strategies that improve health and education, reduce inequality, and spur economic growth – all while tackling climate change and working to preserve our oceans and forests.

Corporates can contribute to SDGs due to their capacity to provide solutions necessary for meeting SDGs. Companies can lead in innovation and contribute to achievement of Sustainable Development Goals.

19. (a) (1) **Restriction on fees based on a Percentage:** According to Clause (10) of Part I of First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct if he charges or offers to charge, accepts or offers to accept in respect of any professional employment fees which are based on a percentage of profits or which are contingent upon the findings, or results of such employment, except as permitted under any regulations made under this Act.

However, Regulation 192 exempts Chartered Accountants in practice to charge fees based on a percentage of profits or contingent upon findings or results for professional work for certain professional services.

Regulation 192 specifically states that in the case of a valuer for the purposes of direct taxes and duties, the fees may be based on a percentage of the value of the property valued.

**Conclusion:** Consequently, CA. Pankaj shall not be deemed to be guilty of professional misconduct, as he is within the permissible scope of charging fees based on a percentage of the property valued.

- (2) **Failed to Supply Information Called For:** In accordance with Clause (2) of Part III of the First Schedule to the Chartered Accountants Act, 1949, a member, whether in practice or not, is considered to be engaged in professional misconduct if he fails to provide the information requested or does not comply with the requirements set forth by the Institute, Council, or any of its Committees, including the Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board, or the Appellate Authority.

**Conclusion:** Therefore, in the given scenario, CA. Anita has neglected to respond to the Institute's letters seeking

confirmation of her appointment date and has not submitted her membership certificate. Consequently, she is deemed to be guilty of professional misconduct as given in Clause (2) of Part III of the First Schedule to the Chartered Accountants Act, 1949.

- (b) Disclosure of Client's Information:** Confidentiality is one of fundamental principles governing professional ethics. Clause (1) of Part I of the Second Schedule to the Chartered Accountants Act, 1949, addresses professional misconduct related to the disclosure of information by a chartered accountant in practice concerning the business of their clients. Such disclosure to any person other than the client, without the client's consent or unless mandated by prevailing law, is considered a breach of conduct. The Code of Ethics emphasizes that this duty continues even after the completion of the assignment, except when disclosure is necessary for the performance of professional duties.

In the provided case, CA. Johnny disclosed significant information about his client's business without obtaining the client's consent, believing that it would enhance the audience's understanding of the topic.

**Conclusion:** Therefore, this action of CA. Johnny constitutes professional misconduct under Clause (1) of Part I of the Second Schedule to the Chartered Accountants Act, 1949.

- 20.** As per Clause (12) of Part I of the First Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he allows a person not being a member of the institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, any balance sheet, profit and loss account, report or financial statements.

The Council has clarified that the power to sign routine documents on which a professional opinion or authentication is not required to be

expressed may be delegated in the following instances and such delegation will not attract provisions of this clause:

- (i) Issue of audit queries during the course of audit.
- (ii) Asking for information or issue of questionnaire.
- (iii) Letter forwarding draft observations/financial statements.
- (iv) Initiating and stamping of vouchers and of schedules prepared for the purpose of audit.
- (v) Acknowledging and carrying on routine correspondence with clients.
- (vi) Issue of memorandum of cash verification and other physical verification or recording the results thereof in the books of the clients.
- (vii) Issuing acknowledgements for records produced. Raising of bills and issuing acknowledgements for money receipts.
- (ix) Attending to routine matters in tax practice, subject to provisions of Section 288 of Income Tax Act.
- (x) Any other matter incidental to the office administration and routine work involved in practice of accountancy.

In the instant case, CA. Tanya, the auditor of KBC Pvt. Ltd. has delegated certain task to his articles and staff such as issue of audit queries during the course of audit, issue of memorandum of cash verification and other physical verification, letter forwarding draft observations/financial statements, issuing acknowledgements for records produced and signing financial statements of the company.

Therefore, CA. Tanya is correct in allowing first four tasks i.e. issue of audit queries during the course of audit, issue of memorandum of cash verification and other physical verification, letter forwarding draft observations/financial statements, issuing acknowledgements for records produced to his staff and articles.

However, if the person signing the financial statements on his behalf is not a member of the institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, CA. Tanya is wrong in delegating signing of financial statements to his staff.

**Conclusion:** In view of this, CA. Tanya would be held guilty of professional misconduct for allowing the person signing the financial statements on his behalf to his articles and staff under Clause 12 of Part 1 of First Schedule of the Chartered Accountants Act, 1949.

**Applicability of Standards / Guidance Notes / Legislative  
Amendments etc. for May, 2024 Examination**

**Final Course**

**Paper 1: Financial Reporting**

**(I) List of topic-wise exclusions from the syllabus**

(1)	(2)	(3)
S. No. in the syllabus	Topics of the syllabus	Exclusions
3.	<p>Application of Indian Accounting Standards (Ind AS) with reference to General Purpose Financial Statements</p> <p>(iv) Ind AS on Assets and Liabilities of the Financial Statements</p> <p>(vii) Other Ind AS</p>	<p><b>Indian Accounting Standard (Ind AS) 16 'Property, Plant and Equipment'</b></p> <ul style="list-style-type: none"> <li>Appendix B- Stripping Costs in the Production Phase of a Surface Mine</li> </ul> <p><b>Indian Accounting Standard (Ind AS) 37 'Provisions, Contingent Liabilities and Contingent Assets'</b></p> <ul style="list-style-type: none"> <li>Appendix A: Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds</li> <li>Appendix B: Liabilities arising from Participating in a Specific Market — Waste Electrical and Electronic Equipment</li> </ul> <ul style="list-style-type: none"> <li>Indian Accounting Standard (Ind AS) 29: Financial Reporting in Hyperinflationary Economies</li> </ul>

		<ul style="list-style-type: none"><li>• Indian Accounting Standard (Ind AS) 104: Insurance Contracts</li><li>• Indian Accounting Standard (Ind AS) 106: Exploration for and Evaluation of Mineral Resources</li><li>• Indian Accounting Standard (Ind AS) 114: Regulatory Deferral Accounts</li></ul>
--	--	---

**(II)** Limited discussion of Accounting Standards has been given at relevant places in the form of differences of particular provision in Ind AS *vis-à-vis* AS. Accounting Standards do not form part of the syllabus. However, with respect to AS 7, AS 9, AS 19 and AS 22 where there are significant differences between Ind AS and AS, questions on these Accounting Standards (i.e. AS 7, AS 9, AS 19 and AS 22) testing differential treatments in both the set of standards (i.e. Ind AS and AS) may be asked in the examination.