FINAL COURSE
GROUP – I

REVISION TEST PAPERS

MAY, 2025

BOARD OF STUDIES (ACADEMIC)

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

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REVISION TEST PAPER, MAY, 2025 – 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 (Academic) 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 November, 2024 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 five 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, 2025 – 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 (Risk Management)
2	Case Scenario (Interest Rate Risk Management)
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	Portfolio Management
10	Security Valuation
11	Security Valuation
12	Mergers, Acquisitions and Corporate Restructuring
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 2025 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, Audit Evidence, Completion and Review, Reporting, Audit Related Services, Digital Auditing and Assurance, Group Audits, Special Features of Audit of Banks & Non-Banking Financial Companies, Overview of Audit of Public Sector Undertakings, Due Diligence, Investigation & Forensic Accounting, 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

ABC Ltd. is a dynamic company engaged in strategic acquisitions to expand its business portfolio. As part of its growth strategy, the company has recently acquired PQR Ltd. and RST Ltd. While these acquisitions present growth opportunities, these acquisitions also include ongoing lawsuits against the acquired companies. However, ABC Ltd. has secured indemnities from the respective sellers to mitigate potential financial risks associated with these legal matters. Following acquisitions took place during the year

(i) ABC Ltd. acquired a beverage company PQR Ltd. from XYZ Ltd. At the time of acquisition, PQR Ltd. is the defendant in a court case whereby certain customers of PQR Ltd. have alleged that products of PQR Ltd. contain pesticides in excess of the permissible levels, which have caused them health damage. PQR Ltd. is being sued for damages of ₹ 2 crores. XYZ Ltd. has indemnified ABC Ltd. for the losses, if any, due to the case for amount up to ₹ 1 crore. The fair value of the contingent liability for the court case is ₹ 0.70 crore.

(ii) ABC Ltd. pays ₹ 50 crores to acquire RST Ltd. from MN Ltd. RST Ltd. manufactured products containing fiber glass and has been named in 10 class actions concerning the effects of these fiber glass, MN Ltd. agrees to indemnify ABC Ltd. for the adverse results of any court cases up to an amount of ₹ 10 crores. The class actions have not specified amounts of damages and past experience suggests that claims may be up to ₹ 1 crore each, but that they are often settled for small amounts. ABC Ltd. makes an assessment of the court cases and decides that due to the potential variance in outcomes, the contingent liability cannot be measured reliably and accordingly no amount is recognised in respect of the court cases.

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).

1. At what amount would ABC Ltd. account for the identified liability related to contingent liability and the indemnification assets at the time of acquisition of PQR Ltd. related to court case by the customer?

   (a) ₹ 2 crores; ₹ 1 crore

   (b) ₹ 1 crore; ₹ 1 crore

   (c) ₹ 0.70 crore; ₹ 1 crore

   (d) ₹ 0.70 crore; ₹ 0.70 crore

2. What will be the impact on goodwill due to recognition of such liability and indemnified asset?

   (a) The net impact on goodwill will be Nil

   (b) Decrease in the value of Goodwill by ₹ 0.30 crore

   (c) Increase in the value of Goodwill by ₹ 0.30 crore

   (d) Increase in the value of Goodwill by ₹ 1 crore

3. Suppose in case the fair value of the identified liability is ₹ 1.20 crores instead of ₹ 0.70 crore, then what will be the value of the liability and the indemnification assets at the time of acquisition of PQR Ltd.?

   (a) ₹ 2 crores; ₹ 1 crore

   (b) ₹ 1.20 crore; ₹ 1 crore

   (c) ₹ 1 crore; ₹ 1 crore

   (d) ₹ 1.20 crores; ₹ 1.20 crores

4. What will be the impact on goodwill due to recognition of such liability and indemnified asset?

   (a) Increase in the value of Goodwill by ₹ 1 crores

   (b) Decrease in the value of Goodwill by ₹ 0.20 crore

(c) Increase in the value of Goodwill by ₹ 0.20 crore

(d) The net impact on goodwill will be Nil

5. On acquisition of RST Ltd. at what amount should indemnification asset be accounted for in relation to 10 class actions?

(a) ₹ 10 crores

(b) ₹ 1 crore

(c) Nil

(d) ₹ 9 crores

Case Scenario II

Choose the most appropriate answer to Questions 6 to 10, based on below mentioned facts:

Date	Amount (₹)	Event
1st January, 20X6	7,500	Asset acquired with depreciation to be charged based on useful life of 10 years
On 31st December, 20X7	240	Indicators of impairment noted and impairment allowance accounted
On 28th February, 20X9		Assets has been classified as held for sale
On 28th February, 20X9	4,600	Fair value less costs to sell
On 30th June, 20X9	5,300	Fair value less costs to sell

6. The amount of depreciation on the asset for the year 20X8 would be-

(a) ₹ 750

(b) ₹ 720

(c) ₹ 240

(d) ₹ 120

7. The amount of depreciation on the asset for the year 20X9 would be-

(a) ₹ 750

(b) ₹ 720

(c) ₹ 240

(d) ₹ 120

8. What will be the carrying value of the asset immediately before its classification as 'Held for Sale' as on 28th February, 20X9?

(a) ₹ 4,920

(b) ₹ 5,040

(c) ₹ 4,600

(d) ₹ 5,300

9. What will be the carrying value of the asset immediately after its classification as 'Held for Sale' as on 28th February, 20X9?

(a) ₹ 4,920

(b) ₹ 5,040

(c) ₹ 4,600

(d) ₹ 5,300

10. What will be the amount of reversal of impairment loss and the carrying value of the asse after reversal of impairment loss as on 30th June, 20X9?

(a) ₹ 560; ₹ 5,300

(b) ₹ 440; ₹ 5,040

(c) ₹ 560; ₹ 5,160

(d) ₹ 700; ₹ 5,300

Ind AS 28 "Investment in Associates & Joint Ventures"

11. X Ltd. acquired a 10% interest in V Ltd. for ₹ 50,000 on 1st June, 20X6. The investment in V Ltd. was accounted for as equity investment (not held for trading) for which irrevocable option has been availed for subsequent measurement of financial assets at FVTOCI. X Ltd. recognized an increase in fair value of ₹ 30,000 in other comprehensive income for the year ended 31st March, 20X7.

X Ltd. acquired an additional 25% interest in V Ltd. for ₹ 2,00,000 on 1st April, 20X7 and achieved significant influence. The fair value of V Ltd.'s net assets was ₹ 2,50,000 at June, 20X6 and had increased to ₹ 4,00,000 on 1st April, 20X7. V Ltd. recorded profits after dividends of ₹ 1,00,000 between 1st June, 20X6 and 1st April, 20X7.

How should X Ltd. account for an investment in V Ltd. on account of piecemeal acquisition when such investment provides X Ltd. significant influence over V Ltd.? Pass necessary journal entries for the same.

Ind AS 109 "Financial Instruments"

12. On 1st April, 20X1, ABC Ltd. issues a 10- year bond with a par value of ₹ 15,00,000 and an annual fixed coupon rate of 8%, which is consistent with market rates for bonds with similar characteristics. ABC Ltd. uses Secured Overnight Financing Rate (SOFR) as its benchmark interest rate. At the date of inception of the bond, SOFR is 5%. At the end of the first year:

- SOFR has decreased to 4.75%; and
- The fair value of bond is ₹ 15,38,110. This value is consistent with an interest rate of 7.6%.
- The remaining cash flows on bond are ₹ 1,20,000 per year for nine years and ₹ 15,00,000 at the end of nineth year. These cash flows discounted at 7.6% equals ₹ 15,38,110.

ABC Ltd. assumes a flat yield curve, that all changes in interest rates result from a parallel shift in the yield curve, and that the changes in SOFR are the only relevant changes in market conditions.

Following discounting factors may be considered

Discount rate @7.75%	**Present value of ₹ 1 payable**
At the end of year 9	51.1 paise
Cumulatively for the years 1–9	6.312
At the end of year 10	47.4 paise
Cumulatively for the years 1–10	6.786

Required

What is the amount transferred to the OCI at the end of Year 1 when bonds were measured at fair value?

Ind AS 32 "Financial Instruments: Presentation"

13. On 1st April, 2X01, A Ltd. issued a 10% convertible debenture with a face value of ₹ 1,000 maturing on 31st March, 2X11. The debenture is convertible into equity share of A Ltd. at a conversion price of ₹ 25 per share. Interest is payable half-yearly in cash. At the date of issue, A Ltd. could have issued non-convertible debt with a ten-year term bearing a coupon interest rate of 11%.

On 1st April, 2X06, the convertible debenture has a fair value of ₹ 1,700.

A Ltd. makes a tender offer to the holder of the debenture to repurchase the debenture for ₹ 1,700, which the holder accepts. On the date of repurchase, A Ltd. could have issued non-convertible debt with a five-year term bearing a coupon interest rate of 8%.

Required

How does A Ltd. account for the repurchase?

Ind AS 103 "Business Combinations"

14. On 1st April, 20X1, PQR Ltd. acquired 30% of the shares of XYZ Ltd. for ₹ 8,000 crores. At 31st March, 20X2, PQR Ltd. recognised its share of the net asset changes of XYZ Ltd. using equity accounting as follows:

(Amounts ₹ in crores)

Share of profit or loss	700
Share of exchange difference in OCI	100
Share of revaluation reserve of PPE in OCI	50

On 1st April, 20X2, PQR Ltd. acquired the remaining 70% of XYZ Ltd. for cash of ₹ 25,000 crores. The following additional information is relevant at that date. **(Amount ₹ in crores)**

Fair value of the 30% interest already owned	9,000
Fair value of XYZ Ltd's identifiable net assets	30,000

Required

How should such business combination be accounted for?

Ind AS 103 "Business Combinations"

15. On 1st January, 20X1, H Ltd. acquired all of the share capital of S Ltd. for ₹ 15,00,000. The book values and the fair values of the identifiable assets and liabilities of S Ltd. at the date of acquisition are set out below, together with their tax bases in S Ltd.'s tax jurisdictions. Any goodwill arising on the acquisitions is not deductible for tax purposes. The tax rates in H Ltd.'s and S Ltd.'s tax jurisdictions are 30% and 40% respectively.

Net assets acquired	Book values ₹ '000	Tax base ₹ '000	Fair values ₹ '000
Land and buildings	600	500	700
Property, plant and equipment	250	200	270
Inventory	100	100	80
Accounts receivable	150	150	150
Cash and cash equivalents	130	130	130
Total assets	1,230	1,080	1,330
Accounts payable	(160)	(160)	(160)
Retirement benefit obligations	(100)	-	(100)
Net assets before deferred tax liability	970	920	(1070)
Deferred tax liability on differences between book values and tax bases (₹ 50 @ 40%)	(20)		
Net assets at acquisition	950	920	1,070

Calculate deferred tax arising on acquisition of S Ltd. and goodwill based on the above information.

Ind AS 21 "The Effects of Changes in Foreign Exchange Rates"

16. P Ltd., incorporated in India owns 70% interest in foreign entity, S Ltd. P Ltd. has INR (₹) as its functional currency while S Ltd. has US dollars as its functional currency. P Ltd. sells its entire investment in S Ltd. for ₹ 3,200 thousand. The following information is provided:

(₹ in thousand)

Particulars	S's Total	P's share (70%)	NCI (30%)
Net assets	4,000	2,800	1,200
Foreign currency translation reserve gain	900	630	270

Required:

How does an entity account for cumulative translation adjustment (CTA) on disposal of a foreign subsidiary?

Ind AS 2 "Inventories"

17. Following information have been provided for A Ltd. which account for its inventories by using FIFO cost formula:

 a) Full capacity is 10,000 labour hours in a year.

 b) Normal capacity is 7,500 labour hours in a year.

 c) Actual labour hours for current period are 6,500 hours.

 d) Total fixed production overhead is ₹ 1,500,

 e) Total variable production overhead is ₹ 2,600.

 f) Total opening inventory is 2,500 units.

 g) Total units produced in a year are 6,500 units.

 h) Total units sold in a year are 6,700 units.

 i) Total closing inventory is 2,300 units.

Required

How will the overhead cost be allocated to inventory at normal capacity and at less than normal production for the current year based on the above information and also show how much expense will be recognized in the statement of profit and loss?

Ind AS 7 "Statement of Cash Flows"

18. The opening balance sheet at 1st April, 20X6 of an Indian company (which account for its transactions in INR (₹), which consists of cash of ₹ 1,00,000 and share capital of ₹ 100,000. The Company borrows a long term loan on 30th September, 20X6 for US $ 2,200 when the rate of exchange is 1 US $= ₹ 87. There are no other transactions during the year. The exchange rate at the balance sheet date of 31st March, 20X7 is 1 US $ = ₹ 85.

The summarized balance sheet at 31st March, 20X7 is as follows:

	₹	₹
Assets		
Cash (1,00,000+1,91,400)		2,91,400
		2,91,400
Equity and liabilities		
Capital and reserves		
Share capital	1,00,000	
Other Equity		
Retained Earning	4,400	1,04,400
Non- current liabilities		
Long -term loan		1,87,000
Total equity and liabilities		2,91,400

Required:

How the foreign exchange difference arising from unsettled transactions will reflect in the Statement of Cash Flows?

Ind AS 24 "Related Party Disclosures"

19. Mr. Y's father owns 100% of the shares in A Ltd. Mr. Y and Mrs. Y own 100% of the shares in B Ltd. Ms. Z who is Mrs. Y's sister, provides

book-keeping services from time to time to B Ltd. However, Ms. Z is not an employee of B Ltd. A Ltd. has increased its loan of ₹ 1,50,000 to B Ltd. to ₹ 2,00,000 during the year, for which A Ltd. charges a below market rate of interest.

Required:

(i) State whether Mr. Y's father & Mrs. Y's sister are related party of B Ltd.

(ii) What disclosure is to be made in the financial statements of both A Ltd. & B Ltd. with respect to the loan given by A Ltd. to B Ltd.?

(iii) Whether B Ltd. is required to disclose the dealings with the sister of Mrs. Y in its financial statements?

Ind AS 102 "Share-based Payment"

20. At 1st April, 20X1 an entity enters into a share-based payment arrangement with its employees. The terms of the award are as follows:

- Employees are required to work for the entity for five years; after that they will receive a cash payment equal to the value of the entity's shares.
- If the entity achieves a successful IPO during the five -year period, the employees will receive free shares rather than a cash payment. So, employees might receive free shares at the time of IPO or a cash payment at the end of 5th year, but not both.
- No employees are expected to leave the entity over the next five years.
- At the date of the award and till the end of second year, it was not probable that a successful IPO would occur before year 5.
- At the end of year 3, a successful IPO becomes probable; and management expects it to occur in year 4.
- At the end of year 4, a successful IPO occurs; and employees receive free shares.
- The fair value of the equity-settled award alternative is ₹ 1,000 at the grant date. The fair value of the cash-settled alternative,

ignoring the probability that an IPO will happen within the five years, is as follows:

- ₹ 50 at the end of year 1;
- ₹ 500 at the end of year 2;
- ₹ 100 at the end of year 3; and
- ₹ 50 at the end of year 4.

Required:

How the entity would account for this transaction?

ANSWERS

Answer to Case Scenario I

1. **Option (d):** ₹ 0.70 crore; ₹ 0.70 crore
2. **Option (a):** The net impact on goodwill will be Nil
3. **Option (b):** ₹ 1.20 crore; ₹ 1 crore
4. **Option (c):** Increase in the value of Goodwill by ₹ 0.20 crore
5. **Option (c):** Nil

Answer to Case Scenario II

6. **Option (b)**: ₹ 720
7. **Option (d):** ₹ 120
8. **Option (a):** ₹ 4,920
9. **Option (c):** ₹ 4,600
10. **Option (c):** ₹ 560; ₹ 5,160
11. While applying equity method, paragraph 10 of Ind AS 28 requires, the investment in an associate to be initially recognized at cost. However, it doesn't include any specific guidance on how to account for existing investment, which is accounted for under Ind AS 109, that subsequently becomes an associate or a joint venture. One may apply

the fair value approach, by drawing an analogy from paragraph 42 of Ind AS 103.

Paragraph 42 of Ind AS 103, 'Business Combinations', deals with the situation where control over an acquiree is achieved in stages. In such a case, the acquirer shall remeasure its previously held equity interest in the acquiree at its acquisitions- date fair value and recognize the resulting gain or loss, if any, in profit or loss or OCI, as appropriate. In prior reporting periods, the acquirer may have recognized changes in the value of its equity interest in the acquiree on OCI. If so, the amount that was recognized in OCI shall be recognized on the same basis as would be required if the acquirer had disposed directly of the previously held equity interest.

On application of the above guidance, following accounting will be done:

Computation of goodwill on gaining significant influence on V Ltd.

Particulars	₹
Fair value of previously held 10% interest [2,00,000/25% x10%]	80,000
Fair value of additional 25% (amount paid)	2,00,000
Cost of investment in associate V Ltd.	2,80,000
Less: Fair value of identifiable net assets acquired (4,00,000 x 35%)	(1,40,000)
Goodwill	1,40,000

Journal Entries

Particulars		Amount (₹)	Amount (₹)
Investment A/c (10%)	Dr.	30,000	
To OCI (Equity)			30,000
Investment in Associates A/c (35%)	Dr.	2,80,000	
To Bank A/c			2,00,000
To Investment (FVTOCI) (10%)			80,000

OCI (Equity)	Dr.	30,000	
To Retained Earning			30,000

12. The amount of change in fair value of the bond that is not attributable to changes in market conditions giving rise to market risk is estimated as follows:

Step (a)

The bond's IRR at the start of the period is 8%.

Step (b)

Because the benchmark interest rate (SOFR) is 5%, the instrument - specific component of the IRR is 3%.

Step (c)

The contractual cash flows of the instrument at the end of the period are:

- Interest of ₹ 1,20,000 [₹ 15,00,000 x 8%] per year for the next 9 years.
- Principal repayment of ₹ 15,00,000 at the end of 9th year.

The present value of these cash flows is calculated using a discount rate of 7.75%. This rate is arrived at as below:

- 4.75% end of period SOFR, plus
- 3% instrument - specific component calculated as at the start of the period

This gives a notional present value of ₹ 15,23,940

= [(15,00,000 x 0.511) + (1,20,000 x 6.312)].

Step (d)

The fair value of the liability at the end of the period is ₹ 15,38,110. Hence, ABC Ltd. should present ₹ 14,170 [₹ 15,38,110 – ₹ 15,23,940] in the OCI.

13. In the financial statements of A Ltd., the carrying amount of the debenture is allocated on issue as follows:

	₹
Liability component	
Present value of 20 half-yearly interest payments of ₹ 50, discounted at 11% (₹ 50 x 11.95)	598
Present value of ₹ 1,000 due in 10 years, discounted at 11%, compounded half-yearly (₹ 1,000 x 0.342)	342
	940
Equity component	
Difference between ₹ 1,000 total proceeds and ₹ 940 allocated above	60
Total proceeds	**1,000**

The repurchase price is allocated as follows:

	Carrying Value (₹)	**Fair Value (₹)**	**Difference (₹)**
Liability component:			
Present value of 10 remaining half-yearly interest Payments of ₹ 50, discounted at 11% and 8% respectively	377	406	
Present value of ₹ 1,000 due in 5 years, discounted at 11% and 8%, compounded half yearly, respectively	585	676	
	962	1,082	(120)
Equity component	60	618	(558)
Total	**1,022**	**1,700**	**(678)**

A Ltd. recognises the repurchase of the debenture as follows: (₹)

Liability component	Dr.	962	
Debt settlement expense (P&L)	Dr.	120	
To Cash			1,082
(To recognize the repurchase of the liability component)			

Equity component	Dr.	60	
Reserves and Surplus	Dr.	558	
To Cash			618
(To recognize the cash paid for the equity component)			

The debt settlement expense represents the difference between the carrying value of the debt component and its fair value.

14. Paragraph 42 of Ind AS 103 provides that in a business combination achieved in stages, the acquirer shall remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, 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 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.

Applying the above, PQR Ltd. records the following entry in its consolidated financial statements: **(Amounts ₹ in crores)**

		Dr.	Cr.
Identifiable net assets of XYZ Ltd.	Dr.	30,000	
Goodwill (W.N.1)	Dr.	4,000	
Foreign currency translation reserve	Dr.	1,00	
PPE revaluation reserve	Dr.	50	
To Cash			25,000
To Investment in associate- XYZ Ltd. (W.N.3)			8,850
To Retained earnings (W.N.2)			50
To Gain on previously held interest in XYZ recognized in Profit or loss (W.N.4)			250
(To recognize acquisition of XYZ Ltd.)			

Working Notes :

1. Goodwill calculated as follows: **(₹ in crores)**

Cash consideration	25,000
Fair value of previously held equity interest in XYZ	9,000
Total consideration	34,000
Fair value of identifiable net assets acquired	(30,000)
Goodwill	4,000

2. The credit to retained earnings represents the reversal of the unrealized gain of ₹ 50 crores in Other Comprehensive Income related to the revaluation of property, plant and equipment. In accordance with Ind AS 16, this amount is not reclassified to profit or loss.

3. The carrying amount of the investment in the associate on 31st March, 20X2 would be as follows: **(₹ in crores)**

Investment in Associate	8,000
Share of profit or loss	700
Share of exchange difference in OCI	100
Share of revaluation reserve of PPE in OCI	50
	8,850

4. The gain on the previously held equity interest in XYZ Ltd. is calculated as follows: **(₹ in crores)**

Fair Value of 30% interest in XYZ Ltd. at 1st April, 20X2	9,000
Carrying amount of interest in XYZ Ltd. at 1st April, 20X2 (W.N.3)	(8,850)
	150
Unrealised gain previously recognized in OCI	100
Gain on previously held interest in XYZ Ltd. recognized in profit or loss	250

15. Calculation of deferred tax arising on acquisition of S Ltd. and goodwill

	₹'000	₹'000
Fair values of S Ltd.'s identifiable assets and liabilities (excluding deferred tax)		1,070
Less: Tax base		(920)
Temporary difference arising on acquisition		150
Net deferred tax liability arising on acquisition of S Ltd. (₹ 1,50,000 @ 40%)– replaces book deferred tax		60
Purchases consideration		1,500
Fair values of S Ltd.'s identifiable assets and liabilities (excluding deferred tax)	1,070	
Deferred tax	(60)	1,010
Goodwill arising on acquisition		490

The tax base of the goodwill is nil, so a taxable temporary difference of ₹ 4,90,000 arises on the goodwill. No deferred tax is recognised on the goodwill. The deferred tax on other temporary differences arising on acquisitions is provided at 40% (not 30%), because taxes will be payable or recoverable in S Ltd.'s tax jurisdictions when the temporary differences are reversed.

16. As per paragraphs 48 and 48B of Ind AS 21, on the disposal of a foreign operation, the cumulative amount of the exchange differences relating to that foreign operation, recognised in other comprehensive income and accumulated in the separate component of equity, shall be reclassified from equity to profit or loss (as a reclassification adjustment) when the gain or loss on disposal is recognised (see Ind AS 1, Presentation of Financial Statements).

Further, the standard states that on disposal of a subsidiary that includes a foreign operation, the cumulative amount of the exchange differences relating to that foreign operation that have been attributed to the non-controlling interests shall be derecognised, but shall not be reclassified to profit or loss.

Where the subsidiary is partially owned (that is, where a non-controlling interest exists) and the parent has sold its entire interest, the amount of the CTA that has been allocated to the non-controlling interest is derecognised, but it is not transferred to profit or loss. Derecognition of the non-controlling interest (that includes the non-controlling interest's share of CTA) will form part of the journal entry to recognise the gain or loss on disposal of the subsidiary.

In P Ltd.'s consolidated financial statements, the following amounts (₹ in thousand) have been recognised in relation to its investment in S Ltd.:

- net assets of ₹ 4,000 and associated non-controlling interests of ₹ 1,200;
- foreign exchange gains of ₹ 900 were recognised in other comprehensive income, of which ₹ 270 was attributable to non-controlling interests and is therefore included in the ₹ 1,200 non-controlling interests;
- ₹ 630 of foreign exchange gains have been accumulated in a separate component of equity relating to P Ltd.'s 70% share in S Ltd.

P Ltd. sells its 70% interest in S Ltd. for ₹ 3,200 and records the following amounts:

Cash/Bank A/c	Dr.	3,200	
NCI	Dr.	1,200	
Foreign Currency Translation Reserve (OCI)	Dr.	630	
To Net assets			4,000
To Profit on disposal {630+(3,200-2,800)}			1,030

It can be seen that ₹ 630 of the foreign currency gains previously recognised in OCI, i.e. the amount attributed to P Ltd. is reclassified to profit or loss (profit on disposal) and adjusted from OCI. However, ₹ 270 of such gains attributed to the non-controlling interests is not reclassified to profit or loss and is derecognised as a part of the NCI balance.

17. Management should allocate fixed overhead costs and variable overhead costs to units produced at a rate of ₹ 0.2 per hour $= \left(\frac{1,500}{7,500}\right)$ and ₹ 0.4 per hour $= \left(\frac{2,600}{6,500}\right)$ respectively.

Fixed production overhead absorption rate:

= Fixed production overhead / Labour hours under normal capacity

= ₹ 1,500/7,500

= ₹ 0.2 per hour

Therefore, Fixed production overhead allocated to 6,500 units produced during the year (one unit per hour) = 6,500 units x ₹ 0.2 = ₹ 1,300. The remaining ₹ 200 of overhead incurred that remains unallocated is recognized as an expense in the profit and loss.

The amount of fixed overhead allocated to inventory is not increased as a result of low production by using normal capacity to allocate fixed overhead.

Variable production overhead absorption rate:

= Variable production overhead / Actual hours for current period

= ₹ 2,600 / 6,500 units

= ₹ 0.4 per hour

The above rate results in the allocation of all variable overheads to units produced during the year.

As each unit has taken one hour to produce (6,500 hours /6,500 units produced), total fixed and variable production overhead recognized as part of cost of inventory:

= Number of units of closing inventory x number of hours to produce each unit x (fixed production overhead absorption rate + variable production overhead absorption rate)

= 2,300 x 1 x (₹ 0.2+ ₹ 0.4) = ₹ 1,380

The remaining ₹ 2,720 {(₹ 1,500 + ₹ 2,600) – ₹ 1,380} is recognized as an expense in the Statement of profit and loss as follows:

	₹
Absorbed in cost of goods sold (FIFO basis) (6,500- 2,300) = 4,200 x ₹ 0.6	2,520
Unabsorbed fixed overheads, also included in cost of goods sold	200
Total	2,720

18. The foreign currency loan, having been translated at the rate ruling at the receipt date to ₹ 1,91,400 (US $ 2,200 x ₹ 87), is translated at the balance sheet date to ₹ 1,87,000 (US $ 2,200 x ₹ 85). The exchange gain of ₹ 4,400 is recognised in the Statement of profit and loss. The cash is made up of ₹ 1,00,000 (received from the share issue) and ₹ 1,91,400 (received on converting the currency loan immediately to ₹).

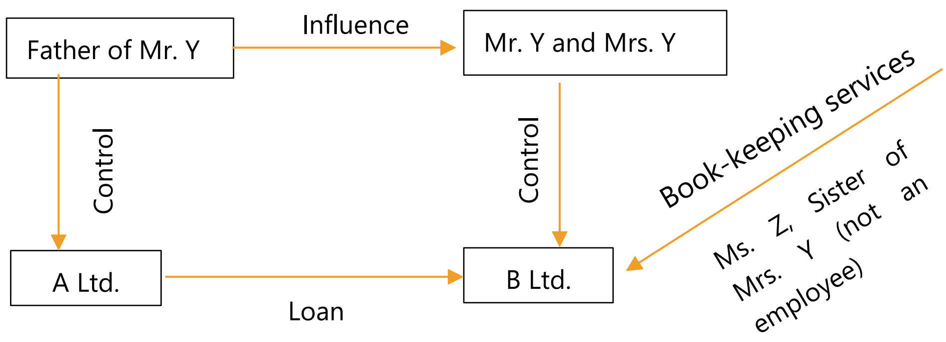
Statement of Cash Flows

	₹
Cash flows from operating activities	
Profit	4,400
Less: Foreign exchange gain	(4,400)
Net cash flow from operating activities A	0
Cash flows from financing activities	
Receipts of foreign currency loan	1,91,400
Net cash flow from financing activities B	1,91,400
Net increase in cash and cash equivalent *A+B*	1,91,400
Cash and cash equivalents at the beginning of the reporting period	1,00,000
Cash and cash equivalents at the end of the reporing period*	2,91,400

* Represents year end cash balances.

The exchange gain of ₹ 4,400 does not have any cash flow effect and is related to financing activities. Therefore, it needs to be eliminated from profit. A similar adjustment would be necessary if the loan remains outstanding at 31st March, 20X8.

19.



(i) Mr. Y's father and Mrs. Y's sister are related parties of B Ltd., if they are 'close family' of either Mr. Y or Mrs. Y. They are close family if they might be expected to influence, or be influenced by, Mr. Y or Mrs. Y in their dealing with B Ltd. Mr. Y's father and Mr. Y and Mrs. Y are 'close family', so Mr. Y's father is a related partly of B Ltd., which is controlled by Mr. Y and Mrs. Y.

Mr. Y's father has a controlling interest in A Ltd. A Ltd. is a related party of B Ltd.

(ii) Both entities should disclose the necessary details regarding the increase in the loan to ₹ 2,00,000 in their financial statements. A Ltd. should also disclose the amounts due to it from B Ltd. on the balance sheet date, together with any provisions and amounts written off. B Ltd. should disclose the amount that it owes to A Ltd. at the balance sheet date alongwith the concessional rate of interest at which the loan was given to B Ltd.

(iii) B Ltd. would have to disclose the transactions with Mrs. Y's sister if the sister might be expected to influence, or be influenced by, either Mr. Y or Mrs. Y in their dealings with B Ltd. based on further facts of the case. In case the influence exists, disclosure to be made as per para 18 of Ind AS 24 about the transactions and the outstanding balances.

20. At the end of first and second year, the entity would not record a charge for the equity-settled award; this is because the vesting conditions are not expected to be met (that is, a successful IPO is not probable).

Hence, a liability is recognised, because cash settlement is probable until year 3. (Refer para 42 of Ind AS 102)

	Dr. (₹)	Cr. (₹)
Year end 31st March, 20X2		
Employee benefits expense (₹ 50 / 5years) Dr.	10	
To Share-based payment liability		10
(Cash settled award recognised over the vesting period)		
Year end 31st March, 20X3		
Employee benefits expense{(₹ 500 x 2/5)- ₹10} Dr.	190	
To Share-based payment liability		190
(Cash -settled award recognised over the vesting period)		

At the end of year 3, a successful IPO becomes probable; so the entity would record a charge for an equity-settled award.

There should also be a reversal of the SBP liability, because this award is now deemed not probable.

Year end 31st March, 20X4	**Dr.**	**Cr.**
Share-based payment Liability Dr.	200	
To Share-based Payment Reserve		200
(Reversal of cash -settled share-based payment, because IPO deemed probable)		

Employee benefits expense {(₹ 1,000 x ¾) - ₹ 200} Dr.	550	
To Share-based Payment Reserve		550
(Equity -Settled award measured at grant date fair value of ₹ 550, because IPO is now deemed probable)		
Year end 31st March, 20X5		
Employee Benefits Expenses Dr.	250	
To Share-based Payment Reserve		250
(Equity settled award recognised over the vesting period)		
Share-based Payment Reserve Dr.	1,000	
To Equity share capital		1,000
(Settlement of share-based payment award through issuance of free shares)		

Equity -settled award measured at fair value of ₹ 1,000. All of the vesting conditions for this ward have been met in year 4; so the award has vested, and the remaining charge of ₹ 250 (₹ 1,000 – ₹ 750) is recognised in the Statement of profit and loss.

PAPER – 2
ADVANCED FINANCIAL MANAGEMENT

QUESTIONS

Risk Management

1. Mr. B is a rational risk taker. He takes his position in a single stock for 4 days in a week. He does not take a position on Friday to avoid weekend effect and takes position only for four days in a week i.e. Monday to Thursday. He transfers the amount on Monday morning and withdraws the balance on Friday morning. He desires to take a maximum exposure in the single stock (not the portfolio) where Value at Risk (VAR) should not exceed the balance lying in his bank account. The position by his manager, as per standing instructions, is taken on the free balance lying in the bank account in the morning on each Monday.

On Monday morning (before opening of the capital market) he has transferred an amount of ₹ 11 Crore to his bank account. A fixed deposit also matured on this Monday. The maturity amount of ₹ 63,42,560 was also credited to his account by the bank in the morning of the Monday. However, Mr. B received the intimation of the same in the evening. The bank needs a minimum balance of ₹ 1,000 all the time.

The other information with respect to stocks X and Y, which are under consideration for this week, is as under:

X		Y	
Return	Probability	Return	Probability
6	0.10	4	0.10
7	0.25	6	0.20
8	0.30	8	0.40

9	0.25	10	0.20
10	0.10	12	0.10

Based on above information, answer the following questions:

I. Available amount which can be used by Mr. B for potential exposure for 4 days on Monday morning shall be.................

(a) ₹ 11,00,00,000

(b) ₹ 11,63,41,560

(c) ₹ 11,00,01,000

(d) ₹ 11,63,42,560

II. The Z-score at a 99% confidence level for Mr. B's Value at Risk (VaR) is ....

(a) 1.64

(b) 1.96

(c) 2.33

(d) 2.58

III. The expected return for the stocks X is ....

(a) 7%

(b) 8%

(c) 9%

(d) 10%

IV. The expected return for the stocks Y is ....

(a) 7%

(b) 8%

(c) 9%

(d) 10%

V. In which stock should Mr. B invest in to maximize his returns while maintaining his Value at Risk (VaR) within acceptable limits?

(a) Stock X

(b) Stock Y

(c) Both stocks are equally good

(d) Neither stock is suitable

Interest Rate Risk Management

2. P Ltd. is planning to borrow an amount of ₹ 60 crores for a period of 3 months in the coming 6 month's time from now. The current rate of interest is 9% p.a., but it is likely to go up in 6 month's time. The company wants to hedge itself against the likely increase in interest rate.

You as CFO has been asked to suggest both traditional as well as modern methods to hedge interest rate risk.

Suppose the banker of P Ltd. has quoted the following Forward Rate Agreement (FRA) rates:

3 x 6	9.10%	9.15%
6 x 9	9.20%	9.30%
9 x 12	9.35%	9.45%

Based on the above information answer the following questions:

I. Suppose if P Ltd. agrees to adopt FRA method to hedge interest rate risk then the interest rate.......... shall be applicable for the same agreement.

(a) 9.10% p.a.

(b) 9.30% p.a.

(c) 9.35% p.a.

(d) 9.45% p.a.

II. Suppose if the actual rate of interest after 6 months happens to be 9.60%, then the settlement amount approximately ....

(a) ₹ 733,855 shall be paid by P Ltd. to its Banker.

(b) ₹ 439,453 shall be paid by P Ltd. to its Banker.

(c) ₹ 439,453 shall be paid by Banker to P Ltd.

(d) ₹ 733,855 shall be paid by Banker to P Ltd.

III. Suppose if the actual rate of interest after 6 months happens to be 8.80%, then the settlement amount approximately ....

(a) ₹ 733,855 shall be paid by P Ltd. to its Banker

(b) ₹ 439,453 shall be paid by P Ltd. to its Banker.

(c) ₹ 439,453 shall be paid by Banker to P Ltd.

(d) ₹ 733,855 shall be paid by Banker to P Ltd.

IV. Which of the following technique is not the modern technique to hedge the interest rate risk ....

(a) Interest Rate Futures

(b) Interest Rate Options

(c) Interest Rate Swaps

(d) Forward Rate Agreement

Derivatives Analysis and Valuation

3. Mr. X, is a Senior Portfolio Manager at ABC Asset Management Company. He expects to purchase a portfolio of shares in 90 days. However, he is worried about the expected price increase in shares in coming day and to hedge against this potential price increase he decides to take a position on a 90-day forward contract on the Index. The index is currently trading at 2290. Assuming that the continuously compounded dividend yield on the same index is 1.75% and risk-free rate of interest is 4.16%, you are required to determine:

(a) The justified forward price on this contract.

(b) The position Mr. X should take in forward contract on the Index.

(c) Gain/ loss on the position taken if after 28 days of the purchase of the contract the Index value stands at 2450.

(d) Gain/ loss on the position taken if at expiration of 90 days the Index Value is 2470.

Note: Take 365 days in a year and value of $e^{0.005942}$ = 1.005960, $e^{0.001849}$ = 1.001851.

4. AB Ltd.'s equity shares are presently selling at a price of ₹ 500 each. An investor is interested in purchasing AB Ltd.'s shares. The investor expects that there is a 70% chance that the price will go up to ₹ 650 or a 30% chance that it will go down to ₹ 450, three months from now. There is a call option on the shares of the firm that can be exercised only at the end of three months at an exercise price of ₹ 550.

   Calculate the following:

   (i) If the investor wants a perfect hedge, what combination of the share and option should he select?

   (ii) Explain how the investor will be able to maintain identical position regardless of the share price.

   (iii) If the risk-free rate of return is 20% p.a. for the three months period, what is the value of the option at the beginning of the period?

   (iv) What is the expected rate of return for the option buyer?

Business Valuation

5. ABC, a large business house is planning to sell its wholly owned subsidiary KLM. Another large business entity XYZ has expressed its interest in making a bid for KLM. XYZ expects that after acquisition the annual earning of KLM will increase by 10%.

   Following information, ignoring any potential synergistic benefits arising out of possible acquisitions, are available:

   (i) Profit after tax for KLM for the financial year which has just ended is estimated to be ₹ 10 crore.

   (ii) KLM's after-tax profit has an increasing trend of 7% each year and the same is expected to continue.

   (iii) Estimated post tax market return is 10% and risk-free rate is 4%. These rates are expected to continue.

   (iv) Corporate tax rate is 30%.

	XYZ	ABC	Proxy entity for KLM in the same line of business
No. of shares	100 lakhs	80 lakhs	--
Current share price	₹ 287	₹ 375	--
Dividend pay out	40%	50%	50%
Debt: Equity at market values	1 : 2	1 : 3	1 : 4
P/E ratio	10	13	12
Equity beta	1	1. 1	1.1

Assume that gearing level of KLM to be the same as for ABC and a debt beta is zero.

You are required :

(a) To calculate appropriate cost of equity for KLM based on the data available for the proxy entity.

(b) A range of values for KLM both before and after any potential synergistic benefits to XYZ of the acquisition.

(c) Compute the market value of KLM as a part of ABC.

Note: Round off calculation up to 2 decimal and compute figure in ₹ crores.

Foreign Exchange Exposure and Risk Management

6. M/s Omega Electronics Ltd. exports air conditioners to Germany by importing all the components from Singapore. The company is exporting 2,400 units at a price of Euro 500 per unit. The cost of imported components is S$ 800 per unit. The fixed cost and other variables cost per unit are ₹ 1,000 and ₹ 1,500 respectively. The cash flows in Foreign currencies are due in six months. The current exchange rates are as follows:

₹/Euro	51.50/55
₹/S$	27.20/25

After six months the exchange rates turn out as follows:

₹/Euro	52.00/05
₹/S$	27.70/75

(A) You are required to calculate loss/gain due to transaction exposure.

(B) Based on the following additional information calculate the loss/gain due to transaction and operating exposure if the contracted price of air conditioners is ₹ 25,000 :

(i) the current exchange rate are as follows:

₹/Euro	51.75/80
₹/S$	27.10/15

(ii) Price elasticity of demand is estimated to be 1.5

(iii) Payments and receipts are to be settled at the end of six months.

7. Z Ltd. importing goods worth USD 2 million, requires 90 days to make the payment. The overseas supplier has offered a 60 days interest free credit period and for additional credit for 30 days an interest of 8% per annum.

The bankers of Z Ltd offer a 30 days loan at 10% per annum and their quote for foreign exchange is as follows:

	₹
Spot 1 USD	82.50
60 days forward for 1 USD	83.40
90 days forward for 1 USD	83.90

You are required to evaluate the following options:

(i) Pay the supplier in 60 days, or

(ii) Avail the supplier's offer of 90 days credit.

Note: -

1. Consider 360 day a year.

2. Round off calculation upto whole number except the applicable rates.

Advanced Capital Budgeting Decisions

8. A firm has an investment proposal, requiring an outlay of ₹ 12 crore. The investment proposal is expected to have two years economic life with no salvage value. In year 1, there is a 0.7 probability that cash inflow after tax will be ₹ 7.50 crore and 0.3 probability that cash inflow after tax will be ₹ 9 crore. The probability assigned to cash inflow (after tax) for the year 2 corresponding to the year / Cash Inflow is as follows:

(₹ in crore)

The cash inflow year 1	₹ 7.50		₹ 9.00	
The cash inflow year 2	Probability		Probability	
	₹ 3.60	0.10	₹ 6.00	0.50
	₹ 4.80	0.50	₹ 7.50	0.30
	₹ 6.60	0.40	₹ 9.00	0.20

The firm uses a 15% discount rate for this type of investment.

Required:

(i) Construct a decision tree for the proposed investment project.

(ii) Calculate the expected net present value (NPV).

(iii) What will be the best outcome and the probability of that occurrence?

(iv) What net present value will the project yield if worst outcome is realized and What is the probability of occurrence of this NPV?

(v) Advice whether the project be accepted or not.

Note:

1. 15% discount factor 1 year 0.870; 2 year 0.756.

2. Carryout all calculations in ₹ crore & round off them upto 2 decimal points.

Portfolio Management

9. Mr. Hari Kumar has categorized all the available stock in the market into the following types:

   (i) Small cap growth stocks

   (ii) Small cap value stocks

   (iii) Large cap growth stocks

   (iv) Large cap value stocks

   Mr. Hari Kumar also estimated the weights of the above categories of stocks in the market index. Further, the sensitivity of returns on these categories of stocks to the three important factor are estimated to be as follows:

Category of Stocks	Weight in the Market Index	Factor I (Beta)	Factor II (Book Price)	Factor III (Inflation)
Small cap growth	15%	0.65	1.95	1.65
Small cap value	20%	1.25	2.23	2.15
Large cap growth	15%	2.25	3.20	8.65
Large cap value	50%	1.325	2.25	9.50
Risk Premium		8.85%	-4.25%	0.80%

   The rate of return on treasury bonds is 5.80%

   Required:

   (a) Using Arbitrage Pricing Theory, determine the expected return on the market index.

   (b) Using Capital Asset Pricing Model (CAPM), determine the expected return on the market index.

   (c) Mr. Hari Kumar wants to construct a portfolio constituting only the 'small cap growth' and 'large cap value' stocks. If the target beta for the desired portfolio is 1, suggest what should be the composition of the same.

   Note: Round off calculations upto 3 decimal points.

Security Valuation

10. Mr. Z will need ₹ 18,00,000 after two years for which he wants to make one-time necessary investment now. He has a choice of two types of bonds. Their details are as below:

	Bond X	Bond Y
Face value	₹ 1,000	₹ 1,000
Coupon	8% payable annually	9% payable annually
Years to maturity	1	4
Current price	₹ 964.44	₹ 909.42
Current yield	12%	12%

Advice Mr. Z whether he should invest all his money in one type of bond or he should buy both the bonds and, if so, in which quantity? Assume that there will not be any call risk or default risk.

Note: -

1. Use PVFs upto 3 decimal points.
2. While the numbers of bonds to be acquired to be rounded off, the remaining calculation shall be rounded off upto 3 decimal points.

11. Capital structure of Sun Ltd., as at 31.3.2023 was as under:

	(₹ in lakhs)
Equity share capital (₹ 100 each)	600
6% Preference share capital	300
9% Debentures	480
Reserves	240

Sun Ltd., earns a profit of ₹ 240 lakhs annually on an average before deduction of income-tax, which works out to 30%, and interest on debentures.

Normal return on equity shares of companies similarly placed is 7.2% provided:

(a) Profit after tax covers fixed interest and fixed dividends at least 3 times.*

(b) Capital gearing ratio is 0.5625.

(c) Yield on equity shares capital is calculated at 50% of profits distributed and at 5% on undistributed profits.

Sun Ltd., has been regularly paying equity dividend of 6%.

Compute the value per equity share of the company assuming that adjustment for risk premium in comparison of similarly placed company shall be made as follows:

(i) 1% for every one time of difference for Interest and Fixed Dividend Coverage.

(ii) 2% for every one time of difference for Capital Gearing Ratio.

$$* \frac{\text{PAT + Debenture Interest}}{\text{Debenture Interest + Preference Dividend}}$$

Mergers, Acquisitions and Corporate Restructuring

12. R Ltd. and S Ltd. are companies that operate in the same industry. The financial statements of both the companies for the current financial year are as follows:

Balance Sheet

Particulars	R. Ltd. (₹)	S. Ltd (₹)
Equity & Liabilities		
Shareholders Fund		
Equity Capital (₹ 10 each)	20,00,000	16,00,000
Retained earnings	4,00,000	-
Non-current Liabilities		
16% Long term Debt	10,00,000	6,00,000
Current Liabilities	14,00,000	8,00,000
Total	**48,00,000**	**30,00,000**

Assets		
Non-current Assets	20,00,000	10,00,000
Current Assets	28,00,000	20,00,000
Total	**48,00,000**	**30,00,000**

Income Statement

	Particulars	R. Ltd. (₹)	S. Ltd. (₹)
A.	Net Sales	69,00,000	34,00,000
B.	Cost of Goods sold	55,20,000	27,20,000
C.	**Gross Profit (A-B)**	13,80,000	6,80,00
D.	Operating Expenses	4,00,000	2,00,000
E.	Interest	1,60,000	96,000
F.	**Earnings before taxes [C-(D+E)]**	8,20,000	3,84,000
G.	Taxes @ 35%	2,87,000	1,34,400
H.	Earnings After Tax (EAT)	5,33,000	2,49,600

Additional Information:

No. of equity shares	2,00,000	1,60,000
Dividend payment Ratio (D/P)	20%	30%
Market price per share	₹ 50	₹ 20

Assume that both companies are in the process of negotiating a merger through exchange of Equity shares:

You are required to:

(i) Decompose the share price of both the companies into EPS & P/E components. Also segregate their EPS figures into Return On Equity (ROE) and Book Value/Intrinsic Value per share components.

(ii) Estimate future EPS growth rates for both the companies.

(iii) Based on expected operating synergies, R Ltd. estimated that the intrinsic value of S Ltd. Equity share would be ₹ 25 per share on its acquisition. You are required to develop a range of justifiable

Equity Share Exchange ratios that can be offered by R Ltd. to the shareholders of S Ltd. Based on your analysis on parts (i) and (ii), would you expect the negotiated terms to be closer to the upper or the lower exchange ratio limits and why?

International Financial management

13. A proposed foreign investment involves creation of a plant with an annual output of 1 million units. The entire production will be exported at a selling price of USD 10 per unit. At the current rate of exchange dollar cost of local production equals to USD 6 per unit. Dollar is expected to decline by 10% or 15%. The change in local cost of production and probability from the expected current level will be as follows:

Decline in value of USD (%)	Reduction in local cost of production (USD/ unit)	Probability
0	-	0.40
10	0.30	0.40
15	0.15 Additional Reduction	0.20

The plant at the current rate of exchange will have a depreciation of USD 1 million annually. Assume local Tax rate as 30%.

You are required to find out:

(i) Annual Cash Flow After Tax (CFAT) under all the different scenarios of exchange rate.

(ii) Expected value of CFAT assuming no repatriation of profits.

(iii) Viability of the investment proposal assuming an initial investment of USD 25 million on plant and working capital with a required rate of return of 11% on investment and on the basis of CFAT arrived under option (ii). The CFAT will grow @ 3% per annum in perpetuity.

Theoretical Questions

14. "Securities are created by dividing the cash flows associated with underlying securities into two or more new securities". Explain the instruments & its types.

15. Explain the various technique explicitly does not involve transaction costs and can be used to offset the foreign exchange exposure completely or partially.

SUGGESTED ANSWERS/HINTS

1. **I** **(b)**
II **(c)**
III **(b)**
IV **(b)**
V **(a)**

2. **I** **(b)**
II **(c)**
III **(a)**
IV **(d)**

3. (a) The Forward Price shall be = $S_0e^{n(r-y)}$

Where S_0 = Spot price n = period

r = risk free rate of interest y = dividend yield

Accordingly,

Forward Price = $2290\ e^{90/365(0.0416 - 0.0175)}$

$= 2290\ e^{0.005942}$

$= 2290(1.005960)$

$= 2303.65$

(b) Mr. X shall take long position in the Forward Contract on Index.

(c) Gain/loss on Long Position after 28 days

$= 2450 - 2290\ e^{(0.0416 - 0.0175)28/365}$

$= 2450 - 2290\ e^{0.001849}$

$= 2450 - 2290(1.001851)$

$= 2450 - 2294.24$

$= 155.76$

(d) Gain/loss on Long Position at maturity

$= S_n - S_0 e^{n(r-y)}$

$= 2470.00 - 2303.65$

$= 166.35$

4. (i) To compute perfect hedge we shall compute Hedge Ratio (Δ) as follows:

$$\Delta = \frac{C1\text{-}C2}{S1\text{-}S2} = \frac{100\text{-}0}{650\text{-}450} = \frac{100}{200} = 0.50$$

The investor should purchase 0.50 share for shortening every 1 call option

Or, the investor should purchase 1 share for shortening every 2 Call Option.

(ii) How the investor will be able to maintain his position if he purchase 0.50 share for 1 call option written.

(a) If price of share goes upto ₹ 650 then value of purchased share will be:

Sale Proceeds of Investment (0.50 x ₹ 650)	₹ 325
Loss on account of Short Position (₹ 650 – ₹ 550)	₹ 100
	₹ 225

(b) If price of share comes down to ₹ 450 then value of purchased share will be:

Sale Proceeds of Investment (0.50 x ₹ 450) ₹ 225

(iii) The Value of Option, say, P at the beginning of the period shall be computed as follows:

(₹ 250 – P) 1.05 = ₹ 225

₹ 262.50 – 1.05P = ₹ 225

₹ 37.5 = 1.05P

P = ₹ 35.71

(iv) Expected Return on the Option

Expected Option Value = (₹ 650 – ₹ 550) × 0.70 + ₹ 0 × 0.30 = ₹ 70

Expected Rate of Return = $\frac{70 - 35.71}{35.71} \times 100$ = 96.02%

5. **(a)** To calculate cost of equity for KLM first we shall calculate β of KLM as follows:

β (equity ungeared for the proxy company) = 1.1 X 4 / [4 + (1 – 0.3)] = 0.94

0.94 = β equity geared X 3/ [3 + (1 - 0.3)]

β equity geared = 1.16

Cost of equity = 0.04 + 1.16 X (0.10 – 0.04)

= 10.96%

(b) Based on the data available range of valuation can be computed using P/E and dividend-based valuation approach.

(i) P/E valuation

(Based on earning of ₹ 10 Crore)

	Using proxy entity's P/E	Using XYZ's P/E
Pre synergistic value	= 12 X ₹ 10 Crore = ₹ 120 Crore	= 10 X ₹ 10 Crore = ₹ 100 Crore
Post synergistic value	= 12 X ₹ 10 Crore X 1.1 = ₹ 132 Crore	= 10 X ₹ 10 Crore X 1.1 = ₹ 110 Crore

(ii) Divided valuation model

	Based on 50% pay-out	**Based on 40% pay-out**
Pre synergistic value	$= \frac{0.5 \times 10 \times 1.07}{0.1096 - 0.07}$ = ₹ 135.10 Crore	$= \frac{0.4 \times 10 \times 1.07}{0.1096 - 0.07}$ = ₹ 108.08 Crore
Post synergistic value	$= \frac{0.5 \times 10 \times 1.1 \times 1.07}{0.1096 - 0.07}$ = ₹ 148.61 Crore	$= \frac{0.4 \times 10 \times 1.1 \times 1.07}{0.1096 - 0.07}$ = ₹ 118.89 Crore

Range of valuation

	P/E Based	**Dividend Based**
Pre synergistic	₹ 100 Crore	₹ 135.10
Post synergistic	₹ 110 Crore	₹ 148.61

(c) Market Price

Although no information is available about the value of KLM, it may be possible to calculate a market value based on proportion of earnings of ABC that is generated by KLM.

Market value of ABC	= 80 Lakh Shares X ₹ 375	= ₹ 300 Crore
Post-tax earnings of ABC	= ₹ 300 crore/13	= ₹ 23.08 Crore

If market value of ABC is allocated to KLM in the proportion of relative earning of KLM to that of ABC, KLM would have a market value of ₹ 300 crore X [10/23.08] = ₹ 129.98 Crore.

KLM's Post Tax earning = ₹ 10 Crore.

If ABC's P/E ratio is applied to it, the market value of KLM becomes ₹ 10 Crore X 13 = ₹ 130 Crore.

6. **(i)** Profit at current exchange rates

2400 [€ 500 × ₹ 51.50 – (S$ 800 × ₹ 27.25 + ₹ 1,000 + ₹ 1,500)]

2400 [₹ 25,750 - ₹ 24,300] = ₹ 34,80,000

Profit after change in exchange rates

2400[€500× ₹ 52 – (S$ 800 × ₹ 27.75 + ₹ 1000 + ₹ 1500)]

2400[₹ 26,000 - ₹ 24,700] = ₹ 31,20,000

Loss due to Transaction Exposure

₹ 34,80,000 – ₹ 31,20,000 = ₹ 3,60,000

(ii) Profit based on new spot exchange rates

2400[₹ 25,000 - (800 × ₹ 27.15 + ₹ 1,000 + ₹ 1,500)]

2400[₹ 25,000 - ₹ 24,220] = ₹ 18,72,000

Profit after change in exchange rates at the end of six months

2400 [₹ 25,000 - (800 × ₹ 27.75 + ₹ 1,000 + ₹ 1,500)]

2400 [₹ 25,000 - ₹ 24,700] = ₹ 7,20,000

Decline in profit due to Transaction Exposure

₹ 18,72,000 - ₹ 7,20,000 = ₹ 11,52,000

Current price of each unit in € = $\frac{₹\ 25,000}{₹\ 51.50}$ = € 485.44

Price after change in Exch. Rate = $\frac{₹\ 25,000}{₹\ 51.75}$ = € 483.09

Change in Price due to change in Exch. Rate

€ 485.44 - € 483.09 = € 2.35 or (-) 0.48%

Price elasticity of demand = 1.5

Increase in demand due to fall in price 0.48 × 1.5 = 0.72%

Size of increased order = 2400 ×1.0072 = 2417 units

Profit = 2417 [₹ 25,000 – (800 × ₹ 27.75 + ₹ 1,000 + ₹ 1,500)]

= 2417 [₹ 25,000 - ₹ 24,700] = ₹ 7,25,100

Therefore, decrease in profit due to Operating Exposure

₹ 18,72,000 – ₹ 7,25,100 = ₹ 11,46,900

Alternatively, if it is assumed that Fixed Cost shall not be changed with change in units then answer will be as follows:

Fixed Cost = 2400[₹ 1,000] = ₹ 24,00,000

Profit = 2417 [₹ 25,000 – (800 × ₹ 27.75 + ₹ 1,500)] – ₹ 24,00,000

= 2417 (₹ 1,300) – ₹ 24,00,000 = ₹ 7,42,100

Therefore, decrease in profit due to operating exposure ₹ 18,72,000 – ₹ 7,42,100 = ₹ 11,29,900

7. (i) Pay the supplier in 60 days

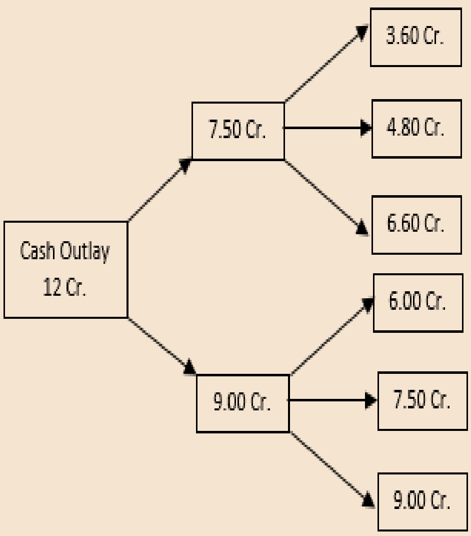
If the payment is made to supplier in 60 days, the applicable forward rate for 1 USD	₹ 83.40
Payment Due	USD 2,000,000
Outflow in Rupees (USD 2000000 × ₹ 83.40)	₹ 16,68,00,000
Add: Interest on loan for 30 days@10% p.a.	₹ 13,90,000
Total Outflow in ₹	₹ 16,81,90,000

(ii) Availing supplier's offer of 90 days credit

Amount Payable	USD 2,000,000
Add: Interest on credit period for 30 days @ 8% p.a.	USD 13,333
Total Outflow in USD	USD 2,013,333
Applicable forward rate for 1 USD	₹ 83.90
Total Outflow in ₹ (USD 2,013,333 × ₹ 83.90)	₹16,89,18,639

Advise: Alternative 1 is better as it entails lower cash outflow.

8. (i) The decision tree diagram is presented in the chart, identifying various paths and outcomes, and the computation of various paths/outcomes and NPV of each path are presented in the following tables:



Path No.	Joint Probability Year 1 × Year 2
1	0.07
2	0.35
3	0.28
4	0.15
5	0.09
6	0.06
	1.00

(ii) The Net Present Value (NPV) of each path at 15% discount rate is given below:

(₹ in crore)

Path	Year 1 Cash Flows (₹)	Year 2 Cash Flows (₹)	Total Cash Inflows (PV) (₹)	Cash Outflows (₹)	NPV (₹)
1.	7.50 × 0.870 = 6.53	3.60 × 0.756 = 2.72	9.25	(12)	(-) 2.75
2.	6.53	4.80 × 0.756 = 3.63	10.16	(12)	(-) 1.84
3.	6.53	6.60 × 0.756 = 4.99	11.52	(12)	(-)0.48
4.	9.00 × 0.870 = 7.83	6.00 × 0.756 = 4.54	12.37	(12)	0.37
5.	7.83	7.50 × 0.756 = 5.67	13.50	(12)	1.50
6.	7.83	9.00 × 0.756 = 6.80	14.63	(12)	2.63

Statement showing Expected Net Present Value

(₹ in crore)

Path	**NPV (₹)**	**Joint Probability**	**Expected NPV (₹)**
1	(-) 2.75	0.07	(-) 0.19
2	(-) 1.84	0.35	(-) 0.64
3	(-) 0.48	0.28	(-) 0.13
4	0.37	0.15	0.06
5	1.50	0.09	0.14
6	2.63	0.06	0.16
			(-) 0.60

(iii) The best outcome will be path 6 when the NPV is at ₹ 2.63 crore. The probability of occurrence of this NPV is 6% and hence expected NPV of ₹ 0.16 crore

(iv) If the worst outcome is realized the project will yield NPV of Negative ₹ 2.75 crore. The probability of occurrence of this NPV is 7% and hence Negative NPV of ₹ 0.19 crore (path 1).

(v) The project should not be accepted because the expected NPV is negative ₹ 0.60 crore based on joint probability.

9. **(a)** Stock's return

Small cap growth = 5.80 + 0.65 × 8.85 + 1.95 × (-4.25) + 1.65 × 0.80 = 4.585

Small cap value = 5.80 + 1.25 × 8.85 + 2.23 × (-4.25) + 2.15 × 0.80 = 9.105

Large cap growth = 5.80 + 2.25 × 8.85 + 3.2 × (-4.25) + 8.65 × 0.80 =19.033

Large cap value = 5.80 + 1.325 × 8.85 + 2.25 × (-4.25) + 9.50 × 0.80 =15.564

Expected return on market index

0.15 x 4.585 + 0.20 x 9.105 + 0.15 x 19.033 + 0.50 x 15.564 = 13.145%

Alternatively, it can also be calculated as follows: -

= 5.80 + [0.65 × 0.15 + 1.25 × 0.2 + 2.25 × 0.15 + 1.325 × 0.5] x 8.85 + [1.95 × 0.15 + 2.23 × 0.2 + 3.2 × 0.15 + 2.25 × 0.5] x (-4.25) + [1.65 × 0.15+2.15 × 0.2+8.65 × 0.15 + 9.5 × 0.5] x 0.8

= 5.80 + 11.925 + (-9.960) + 5.38 = 13.145%

(b) Using CAPM,

Small cap growth = 5.80 + 0.65 × 8.85 = 11.553%

Small cap value = 5.80 + 1.25 × 8.85 = 16.863%

Large cap growth = 5.80 + 2.25 × 8.85 = 25.713%

Large cap value = 5.80 + 1.325 × 8.85 = 17.526%

Expected return on market index

= 0.15 x 11.553 + 0.20 x 16.863 + 0.15 x 25.713 + 0.50 x 17.526 = 17.726%

(c) Let us assume that Mr. Hari will invest X_1% in small cap value stock and X_2% in large cap growth stock

$X_1 + X_2 = 1$

$0.65\ X_1 + 1.325\ X_2 = 1$

$0.65\ X_1 + 1.325(1 - X_1) = 1$

$0.65\ X_1 + 1.325 - 1.325\ X_1 = 1$

$0.325 = 0.675\ X_1$

$$\frac{0.325}{0.675} = X_1$$

Hence, $0.481 = X_1$ & $X_2 = 0.519$

Accordingly, 48.10% of fund should be invested in small cap growth category of stocks and balance 51.90% of funds should be invested in large cap value stocks.

10. To decide in which bond Mr. Z should invest, we shall compute duration of each bond as follows:

Duration of Bond X

Year	*Cash flow*	*P.V. @ 12%*		*Proportion of bond value*	*Proportion of bond value x time (years)*
1	1,080	0.893	964.44	1.000	1.000

Duration of the Bond is 1 year.

Duration of Bond Y

Year	*Cash flow*	*P.V. @ 12%*		*Proportion of bond value*	*Proportion of bond value x time (years)*
1	90	0.893	80.37	0.089	0.089
2	90	0.797	71.73	0.079	0.158
3	90	0.712	64.08	0.070	0.210
4	1,090	0.636	693.24	0.762	3.048
			909.42	1.000	3.505

Thus, duration of the Bond is 3.505 years.

Alternatively, it can also be computed as follows:

Year	Cash Flow	PVF @12%	Present Value (PV)	Year × PV
1	90	0.893	80.37	80.37
2	90	0.797	71.73	143.46
3	90	0.712	64.08	192.24
4	1090	0.636	693.24	2772.96
			909.42	3189.03

$$\text{Duration} = \frac{3189.03}{909.42} = 3.507$$

Let x_1 be the investment in Bond X and therefore investment in Bond Y shall be $(1 - x_1)$. Since the required duration is 2 years the proportion of investment in each of these two securities shall be computed as follows:

$2 = x_1 + (1 - x_1)\ 3.505$ or $2 = x_1 + (1 - x_1)\ 3.507$

$x_1 = 0.60$

Accordingly, the proportion of investment shall be 60% in Bond X and 40% in Bond Y respectively.

Amount of investment

Bond X	***Bond Y***
PV of ₹ 18,00,000 for 2 years @ 12% x 60% = ₹ 18,00,000 (0.797) x 60% = ₹ 8,60,760 No. of Bonds to be purchased = ₹ 8,60,760 /₹ 964.44 = 892.50 i.e. Thus, 893 bonds	PV of ₹ 18,00,000 for 2 years @ 12% x 40% = ₹ 18,00,000 (0.797) x 40% = ₹ 5,73,840 No. of Bonds to be purchased = ₹ 5,73,840 /₹ 909.42 = 631 i.e. Thus, 631 bonds

Note:

(i) The investor has to keep the money invested for two years. Therefore, the investor can invest in both the bonds with the assumption that Bond X will be reinvested for another one year on same returns.

(ii) Further, in the above computation, Modified Duration can also be used instead of Duration.

11. (a) Calculation of Profit after tax (PAT)

	₹
Profit before interest and tax (PBIT)	2,40,00,000
Less: Debenture interest (₹ 4,80,00,000 × 9/100)	43,20,000
Profit before tax (PBT)	1,96,80,000
Less: Tax @ 30%	59,04,000
Profit after tax (PAT)	1,37,76,000
Less: Preference Dividend	

(₹ 3,00,00,000 × 6/100)	18,00,000	
Equity Dividend (₹ 6,00,00,000 × 6/100)	36,00,000	54,00,000
Retained earnings (Undistributed profit)		83,76,000

Calculation of Interest and Fixed Dividend Coverage

$$= \frac{\text{PAT} + \text{Debenture interest}}{\text{Debenture interest} + \text{Preference dividend}}$$

$$= \frac{1{,}37{,}76{,}000 + 43{,}20{,}000}{43{,}20{,}000 + 18{,}00{,}000}$$

$$= \frac{1{,}80{,}96{,}000}{61{,}20{,}000} = 2.96 \text{ times}$$

(b) Calculation of Capital Gearing Ratio

$$\text{Capital Gearing Ratio} = \frac{\text{Fixed charges bearing funds}}{\text{Equity shareholders' funds}}$$

$$= \frac{\text{Preference Share Capital} + \text{Debentures}}{\text{Equity Share Capital} + \text{Reserves}} =$$

$$\frac{3{,}00{,}00{,}000 + 4{,}80{,}00{,}000}{6{,}00{,}00{,}000 + 2{,}40{,}00{,}000}$$

$$= \frac{7{,}80{,}00{,}000}{8{,}40{,}00{,}000} = 0.93$$

(c) Calculation of Yield on Equity Shares:

Yield on equity shares is calculated at 50% of profits distributed and 5% on undistributed profits:

	(₹)
50% on distributed profits (₹ 36,00,000 × 50/100)	18,00,000
5% on undistributed profits (₹ 83,76,000 × 5/100)	4,18,800
Yield on equity shares	22,18,800

Yield on equity shares % $= \dfrac{\text{Yield on shares}}{\text{Equity share capital}} \times 100$

$= \dfrac{22,18,800}{6,00,00,000} \times 100 = 3.70\%$

Calculation of Expected Yield on Equity shares

(a) Interest and fixed dividend coverage of Sun Ltd. is 2.96 times but the industry average is 3 times. Therefore, risk premium is added to Sun Ltd. Shares @ 1% for every 1 time of difference.

Risk Premium = 3.00 – 2.96 (1%) = 0.04 (1%) = 0.04%

(b) Capital Gearing ratio of Sun Ltd. is 0.93 but the industry average is 0.5625 times. Therefore, risk premium is added to Sun Ltd. shares @ 2% for every 1 time of difference.

Risk Premium = (0.5625 – 0.93) (2%) = 0.37 (2%) = 0.74%

	(%)
Normal return expected	7.20
Add: Risk premium for low interest and fixed dividend coverage	0.04
Add: Risk premium for high interest gearing ratio	0.74
	7.98

Value of Equity Share

$= \dfrac{\text{Actual yield}}{\text{Expected yield}} \times \text{Paid-up value of share} = \dfrac{3.70}{7.98} \times 100 = ₹\ 46.37$

12. (i) Determination of EPS, P/E Ratio, ROE and BVPS of R Ltd. & S Ltd.

	R Ltd.	S Ltd.
EAT (₹)	5,33,000	2,49,600
N	200000	160000
EPS (EAT÷N)	2.665	1.56
Market Price Per Share	50	20
PE Ratio (MPS/EPS)	18.76	12.82

Equity Fund (Equity Value)	2400000	1600000
BVPS (Equity Value ÷ N)	12	10
ROE (EAT÷ EF) or	0.2221	0.156
ROE (EAT ÷ EF) x 100	22.21%	15.60%

(ii) Determination of Growth Rate of EPS of R Ltd.& S Ltd.

	R Ltd.	S Ltd.
Retention Ratio (1-D/P Ratio)	0.80	0.70
Growth Rate (ROE x Retention Ratio) or	0.1777	0.1092
Growth Rate (ROE x Retention Ratio) x 100	17.77%	10.92%

(iii) Justifiable equity share exchange ratio

(a) Market Price Based = MPS_S/MPS_R = ₹ 20/ ₹ 50 = 0.40:1 (lower l

(b) Intrinsic Value Based = ₹ 25/ ₹ 50 = 0.50:1 (max. limit)

Since R Ltd. has higher EPS, PE, ROE and higher growth expectations the negotiated term would be expected to be closer to the lower limit, based on existing share price.

13. (i) Calculation of Annual CFAT

	Scenario 1	Scenario 2	Scenario 3
Annual Sales (in units) (A)	10,00,000	10,00,000	10,00,000
	US $	**US $**	**US $**
Selling price p.u.	10.00	10.00	10.00
Cost p.u.	6.00	5.70	5.55
Profit p.u. (B)	4.00	4.30	4.45
Total Profit (A x B)	40,00,000	43,00,000	44,50,000
Less: Depreciation	10,00,000	9,00,000	8,50,000
PBT	30,00,000	34,00,000	36,00,000

Less: Tax @30%	9,00,000	10,20,000	10,80,000
PAT	21,00,000	23,80,000	25,20,000
Add: Depreciation	10,00,000	9,00,000	8,50,000
Expected CFAT (US$)	31,00,000	32,80,000	33,70,000

(ii) Expected value of CFAT

= US$ 31,00,000 x 0.4 + US$ 32,80,000 x 0.4 + US$ 33,70,000 x 0.2

= US$ 32,26,000

(iii) Viability of Proposal:

Expected CFAT = US $ 32,26,000

Expected Growth Rate = 3%

Expected Value of inflow in perpetuity = $\frac{\text{US\$}32{,}26{,}000(1.03)}{0.11-0.03}$

= $\frac{33{,}22{,}780}{0.08}$ = US$ 4,15,34,750

	US $
Value of Inflows	4,15,34,750
Less: Initial Outlay	2,50,00,000
NPV of project	1,65,34,750

Since NPV is positive, project is viable.

14. Stripped Securities are created by dividing the cash flows associated with underlying securities into two or more new securities. Those two securities are as follows:

(i) Interest Only (IO) Securities

(ii) Principle Only (PO) Securities

As each investor receives a combination of principal and interest, it can be stripped into two portion of Interest and Principle.

Accordingly, the holder of IO securities receives only interest while PO security holder receives only principal. Being highly volatile in nature these securities are less preferred by investors.

In case yield to maturity in market rises, PO price tends to fall as borrower prefers to postpone the payment on cheaper loans. Whereas if interest rate in market falls, the borrower tends to repay the loans as they prefer to borrow fresh at lower rate of interest.

In contrast, value of IO's securities increases when interest rate goes up in the market as more interest is calculated on borrowings.

However, when interest rate due to prepayments of principals, IO's tends to fall.

Thus, from the above, it is clear that it is mainly perception of investors that determines the prices of IOs and POs

15. Internal Techniques are those techniques explicitly do not involve transaction costs and can be used to completely or partially offset the exposure. These techniques can be further classified as follows:

(i) **<u>Invoicing in Domestic Currency:</u>** Sellers usually wish to sell in their own currency or the currency in which they incur cost. This avoids foreign exchange exposure but buyers' preferences may be for other currencies. Many markets, such as oil or aluminum, in effect require that sales be made in the same currency as that quoted by major competitors, which may not be the seller's own currency. In a buyer's market, sellers tend increasingly to invoice in the buyer's ideal currency. The closer the seller can approximate the buyer's aims, the greater chance he or she has to make the sale.

(ii) **Leading and Lagging:** Leading and Lagging refer to adjustments at the time of payments in foreign currencies. Leading is the payment before due date while lagging is delaying payment post the due date. These techniques are aimed at taking advantage of expected devaluation and/or revaluation of relevant currencies. Lead and lag payments are of special importance in the event that forward contracts remain inconclusive. When we take reverse the example-revaluation expectation- it could be attractive for lagging.

(iii) **Netting:** Netting involves associated companies, which trade with each other. The technique is simple. Group companies merely settle inter affiliate indebtedness for the net amount owing. Gross intra-group trade, receivables and payables are netted out. The simplest scheme is known as bilateral netting and involves pairs of companies. Each pair of associates nets out their own individual positions with each other and cash flows are reduced by the lower of each company's purchases from or sales to its netting partner. Bilateral netting involves no attempt to bring in the net positions of other group companies.

(iv) **Matching:** Although netting and matching are terms which are frequently used interchangeably, there are distinctions. Netting is a term applied to potential flows within a group of companies whereas matching can be applied to both intra-group and to third-party balancing.

(v) **Price Variation:** Price variation involves increasing selling prices to counter the adverse effects of exchange rate change. This tactic raises the question as to why the company has not already raised prices if it is able to do so. In some countries, price increases are the only legally available tactic of exposure management.

(vi) **Asset and Liability Management:** This technique can be used to manage balance sheet, income statement or cash flow exposures. Concentration on cash flow exposure makes economic sense but emphasis on pure translation exposure is misplaced. Hence, our focus here is on asset liability management as a cash flow exposure management technique.

PAPER – 3: ADVANCED AUDITING, ASSURANCE AND PROFESSIONAL ETHICS

QUESTIONS

PART A: Multiple Choice Questions

Integrated Case Scenarios

WYZ Ltd., incorporated during the year 2002-03, is a leading unicorn startup and top manufacturer of silicon wafers, with two advanced plants and over 6,000 employees. As a pioneer in its industry to be listed on the stock exchange, WYZ Ltd. underscores its longstanding and influential presence in the financial market. The company consistently complies with SEBI's Listing Obligations and Disclosure Requirements Regulations of 2015, ensuring regulatory adherence and maintaining credibility among investors and stakeholders.

Considering the nature, size and extent, the company has appointed M/s KAP & Co. and M/s BMS & Co. as their joint auditors. Both the Firms divided the work in accordance with the SA 299, shared the allocation of task to Those Charged with Governance and started conducting the audit procedures.

During the audit engagement, M/s KAP & Co. was assigned to verify the Property Plant & Equipment (PPE) Register. Mr. K, the engagement partner of M/s KAP & Co., carried out the verification process, however, he did not maintain any documentation of the same. Additionally, he did not perform impairment testing on the PPE at the end of the financial year.

Mr. B, the engagement partner of M/s BMS & Co., was responsible for verification of procure to pay process (P2P). However, he was informed by management that Mr. E, their Internal Auditor, has already verified P2P Process and carried out relevant audit procedures and thereby he relied on the work of Mr. E. He neither conducted any independent audit procedure to evaluate the work of the internal auditor nor documented his conclusion regarding the evaluation of the adequacy of work of internal auditors.

Moreover, looking at the increase in the scale of business, the management of WYZ Ltd. took the decision to implement ERP in its business during the year and gave contract to INFO Ltd. to develop an ERP suitable for its business. The development of ERP was completed on Aug 12th, 2023. The management started adoption of ERP and replacing its old practices. The adoption took a span of 4 months and was successfully completed on Dec 3rd, 2023. The previous software did not have an audit trail feature and the audit trail was operational from Dec 3rd, 2023. However, the auditors of the company have not reported anything on the above matter relating to the audit trail in their main audit report.

In addition to the above, the WYZ Ltd., has one Indian wholly owned subsidiary, ABC Private Ltd., who is in the business of acquisition of shares and securities. M/s PQR & Co. are the auditors of ABC Private Ltd.

The important financial information of ABC Private Ltd. is as under:

Sr. No	Particular	Amount (₹)
1.	Paid-up Capital	₹ 67 Lakhs
2.	Loans and Borrowings from Financial Institution	₹ 72 lakhs
3.	Turnover	₹ 154 lakhs
4.	Reserve and Surplus	₹18.36 lakhs

Based on the above case scenario, answer the following MCQs:

1. Mr. K, the engagement partner of M/s KAP & Co, failed to maintain any documentation of the whole verification process and did not perform impairment testing on the PPE at the end of the financial year. Select the appropriate option as per SA 299.

   (a) Mr. K is severally responsible for his own actions and the said work was his responsibility.

   (b) No, Mr. B & Mr. K are jointly responsible as they both were joint auditors.

   (c) Mr. K is responsible as well as Mr. B is responsible, since Mr. B was compulsorily required to verify the work of Mr. K and he has not verified the same.

   (d) Neither Mr. K nor Mr. B is liable for the actions of Mr. K.

2. The management of the company has adopted a new ERP system and accordingly, the audit trail was maintained from Dec 03rd, 2023 only in the new ERP System. Whether the action of auditors with respect to reporting requirement of audit trail was justified?

   (a) Yes, the action of auditors was justified as it was the first year of implementation of ERP. Hence the auditors are not liable to report the same.

   (b) Yes, the action of auditors was justified as the audit trail was operational during the year and hence the auditors are not liable to report the same.

   (c) No, the action of the auditors was not justified as the audit trail was not operational throughout the year and hence it is the duty of the auditors to report the same in the main audit report.

   (d) Yes, the action of the auditors was justified as the audit trail need not to be reported in the main audit report.

3. Mr. B, engagement partner of M/s BMS & Co., was responsible for verifying Procure to Pay Process, he did not perform any procedure and relied upon the work of Internal Auditor, without keeping any documentation. Which of the following is correct as per SA 610?

   (a) Mr. B can rely on the work of the Internal Auditor. However, he must first discuss with Internal audit function and also evaluate the adequacy of work of Internal Auditor and must document the same regarding the evaluation of work of Internal Auditor.

   (b) Internal Auditor has already performed audit procedure on the P2P Process and hence the Statutory Auditor can rely on the work without any further audit procedure and documentation.

   (c) Audit procedure and the scope of Internal Audit are altogether different from Statutory Audit and therefore, the Statutory Auditor cannot use the work of Internal Auditor.

   (d) Internal Auditor has already performed audit procedure on the P2P Process and hence the Statutory Auditor can rely on the work of Internal Auditor after evaluating his work. However, Statutory auditor is not required to document the same.

4. Considering the above case, whether reporting under CARO, 2020 will be applicable to ABC Private Ltd.?

   (a) No, since the company is a private limited company.

   (b) No, since the company is in the business of acquisition of shares and securities.

   (c) Yes, since the company is wholly owned subsidiary of listed company WYZ Ltd.

   (d) No, since the company is a small company as per the Companies Act, 2013.

5. While preparing a consolidated financial statement of WYZ Ltd., division of responsibility between auditors of WVZ Ltd. and auditor of ABC Private Ltd. should be reported in:

   (a) Emphasis of Matter Paragraph.

   (b) Key Audit Matter Section.

   (c) Going Concern Paragraph.

   (d) Other Matter Paragraph.

Independent MCQs

6. Suban Engineering, a borrower of the branch, had fully utilized its sanctioned cash credit limit of ₹ 400 Lacs, with an outstanding balance of ₹ 413 Lacs as of March 31, 2024. The bank classified the account as a Sub-standard Asset.

   During an inspection, the DGM observed that the borrower's premises were damaged, with no machinery, stock, or other assets present. The borrower was unreachable, and an independent verification of assets confirmed that no mortgaged security was available, except for a piece of land with a realizable value of ₹ 33 Lacs. The bank accepted this report and made a provision considering the account as a Sub-standard Asset.

   Whether correct classification and provisioning norms have been applied in the account of Suban Engineering?

(a) The account is correctly classified, but provision should be made for hundred percent of the unsecured portion besides making specified provision on secured portion.

(b) The account should have been classified as Doubtful asset and besides making required provision on secured portion, provision should have been made for hundred percent of the unsecured portion.

(c) The account should have been classified as Loss asset and full provision should have been made in the books of accounts.

(d) The account should have been classified as Doubtful asset and full provision should have been made in the books of accounts.

7. CA Praveen is appointed by KSN Ltd. for the year 2023-24. While verifying payroll data of the company, it has come to his notice that provisions of law preventing employment of child labour are not being adhered to and company is employing child labour. The company also exports part of its turnover and matter has gone unnoticed in compliance audits carried out by agencies of overseas buyers.

With respect to the auditor's observation relating to the matter of child labour, which is the most appropriate course of action for him to proceed in this matter?

(a) CA Praveen should ignore the matter as it will not affect financial statements.

(b) CA Praveen must report the matter to the concerned government department.

(c) CA Praveen should obtain further information to evaluate the possible effect on financial statements. Besides, he should evaluate implications of non-compliance for audit risk assessment.

(d) CA Praveen should express a modified opinion in the audit report.

8. Mohini Ltd. paid their arrears of undisputed statutory dues just a day before the date of the audit report. After this, now the auditor believes that only disputed dues need to be reported under the CARO, 2020 as undisputed dues are paid before the date of the audit report. Which of

the following is the most appropriate course of action for the auditor in this situation?

(a) The auditor is required to report the disputed statutory dues only in accordance with clause (viii)(b) of Para 3 of CARO, 2020, as there is no requirement to report undisputed statutory dues if they are paid on or before the date of the audit report.

(b) The auditor is required to report both disputed and undisputed statutory dues in accordance with clause (vii)(a) & (b) of Para 3 of the CARO, 2020.

(c) The auditor should consult with legal counsel to determine the specific reporting requirements for disputed and undisputed statutory dues under CARO, 2020.

(d) The auditor should discuss the matter with management and obtain their agreement to report both disputed and undisputed statutory dues in the CARO, 2020 report.

PART B: DESCRIPTIVE QUESTIONS

Standards on Auditing, Statements and Guidance Notes

Quality Control

9. M/s JinKushal & Co. has been appointed as an auditor of SC Ltd. for the financial year 2023-24. CA Jin, one of the partners of M/s JinKushal & Co., completed entire routine audit work by 19th June, 2024. Unfortunately, on the very next morning, while roving towards office of SC Ltd. to sign final audit report, he met with a road accident and died. CA Kushal, another partner of M/s JinKushal & Co., therefore, signed the accounts of SC Ltd., without reviewing the work performed by CA Jin. State with reasons whether CA Kushal is right in expressing an opinion on financial statements, the audit of which is performed by another auditor.

Audit Evidence

10. During the audit of the financial statements of Looks Limited for the year ended March 31, 2024, CA Suyash, the statutory auditor requested

external confirmation for certain trade receivables and trade payables as part of audit procedures in accordance with SA 505:

(i) CA Suyash sent a confirmation request to a debtor for balance of ₹ 15,50,000 which was outstanding for more than 6 months, insisting him to respond directly to the auditor, confirming whether they agree or disagree with the balance stated.

(ii) He also sent a confirmation request to a creditor with an outstanding balance of ₹ 13,25,000 requesting a response only if there was a disagreement with the stated amount.

CA Suyash received responses from the aforementioned debtor and creditor in following manner:

- The debtor confirmed that, as per their records, they owed ₹ 14,90,000 to Looks Limited instead of ₹ 15,50,000 as per the company's books.
- The creditor did not respond to the confirmation request.

Identify and explain the type of confirmation request sent by the auditor to the debtor and creditor. Also, discuss the course of action the auditor should take for the discrepancy in the confirmation received from the debtor and non-receipt of confirmation from the creditor.

Completion and Review

11. Udit & Co. is the statutory auditor of Fun Journey Ltd., a company engaged in the tours and travel business. The company has an annual turnover of ₹ 1,200 crores and profits of ₹ 150 crores. While planning, the auditors discussed the requirement for a written representation letter from management for confirming that:

(i) The auditor is provided with all relevant information and access as agreed in the terms of the audit engagement; and

(ii) All transactions have been recorded and are reflected in the financial statements

As the audit was near to completion, the auditor disagreed with the management on one of the matters including need of written representation contending that verbal confirmations given during the audit should be sufficient. Thus, separate written representation is not required. Udit & Co., however, explained that under SA 580 obtaining a formal written statement from management is mandatory. Fun Journey Ltd. refuses to provide a written representation letter, despite the auditor's several requests.

(a) Whether the contention of auditor for seeking written representation letter is justified?

(b) What should be the form of such written representation?

(c) How should the auditor proceed if management refuses to provide the written representation?

Reporting

12. Comment with reference to the provisions of CARO, 2020:

(a) Relon Limited has a turnover of ₹ 650 crores during the financial year 2023-24. It has outstanding dues towards income-tax of ₹ 15 lakhs since July 2023. When inquired by the auditor, the company's management informed him that they have filed an objection letter for the said demand with the Income-tax Authorities, however, no response is received from the department. Is there any reporting responsibility of auditor under CARO, 2020?

(b) During the audit, CA Kunal found that physical verification of inventories of the company has been conducted by management on regular interval. The following is a summary of inventory as per physical verification conducted by management vis-à-vis its books of accounts as at the year-end:

(Amount ₹ in crores)

Particulars	As per physical verification	As per books of accounts
Raw material	1,160	1,180
Work-in-progress	410	430
Finished goods	2,500	2,790
Stores and spares	220	180
Total	**4,290**	**4,580**

Audit Related Services

13. Compilation engagement is an engagement in which a practitioner applies accounting and financial reporting expertise to assist management in the preparation and presentation of financial information of an entity in accordance with an applicable financial reporting framework and issues a report.

    (i) For what purposes may the financial information prepared under such an engagement be required?

    (ii) Briefly discuss the elements of Practitioner's report for such engagement.

Digital Auditing and Assurance

14. Yuvi, a finance manager at DCB Ltd., received a text message on his mobile phone claiming to be from his bank. The message states that:

    "Dear Customer, Your account has been temporarily suspended due to suspicious activity. To reactivate, please verify your details by clicking on the following link: [sendyourinfo-link.com]. Failure to do so within 24 hours will result in account deactivation. Thank you for banking with us".

    Yuvi is worried about his account security. Which type of phishing cyberattack Yuvi fell victim to? Also explain other types of such phishing attack.

Group Audits

15. Advik Investments Ltd. is a company having paid up share capital of ₹ 1 crore, it has a subsidiary, Investors Fund Management Ltd. Major business of Advik Investments Ltd. is to pool money from investors on a collective basis and invest this money in various funds. This company pooled ₹ 10 crore from a number of clients, which represent the Company's shareholders.

    While auditing books of accounts of Advik Investments Ltd. CA Chirag observed that whole amount of ₹ 12 crore pooled has been invested in shares and debentures of various companies and profit earned due to appreciation of the prices of these shares has been distributed to various shareholders of the company. The performance of all of its investments is measured on fair value basis.

Now, CA Chirag raised an issue while auditing financial statements of Advik Investments Ltd. whether the consolidated financial statements are required as per Section 129(3) of the Companies Act, 2013? Analyse the above issue and give your opinion.

Special Features of Audit of Banks & Non-Banking Financial Companies

16. Nutan & Co. has been appointed as a statutory auditor of JOE Bank Ltd., a private sector bank, registered with RBI. Mr. Chahal, the engagement partner, while performing the audit as per the checklist, noted down the following points, which would be part of the audit queries, as tabulated below:-

Sr. No.	Queries
1	One of the NPAs' was sold for a value higher than the net book value. Profit was not recognized but the excess provision in respect of the same has been reversed.
2	Interest in a State Government Guaranteed advance has been taken to income even though such advance has remained overdue for more than 90 days.
3	There is an account for which the ad hoc limit has not been reviewed for 180 days from the date of such ad hoc sanction and such account has been treated as a performing asset in the books.
4	On verification of outstanding forward exchange contracts, the 'net position' in respect of one of the foreign currencies was not squared and was uncovered by a substantial amount.
5	In the case of one of the accounts, an additional temporary limit has been sanctioned for 25% of the existing limit and for 120 days tenure.

Please provide the reasons due to which such queries would have been raised by Mr. Chahal and describe the actions that may be taken by the person responsible on behalf of JOE Bank Ltd. for solving such queries.

Overview of Audit of Public Sector Undertakings

17. A state government owned PSU was involved in setting up of a thermal power plant in the state. The C & AG, in its audit report, pointed out delay in completion of work due to failure to decide on the type of water treatment in the cooling plant on a timely basis. Besides, other reasons leading to delay like frequent changes in lay-out and re-testing of soil by the company were pointed out. What kind of audit is referred in the above case? Describe the methods which could be used in conducting such audits.

Due Diligence, Investigation & Forensic Accounting

18. MF Ltd., a manufacturing company specialising in industrial and consumer products, has been experiencing significant inventory shortages despite maintaining detailed procurement and production records. The management suspects fraudulent activity, as discrepancies have been noticed in stock reconciliation, production wastage reports, and inventory adjustments.

    Some of the reason for suspicion include:

    - Manual adjustments in stock records on frequent basis.
    - Higher than usual production wastage, inconsistent with historical data.
    - Raw materials recorded as issued for production but missing from factory floors.
    - Finished goods dispatched but not recorded in sales accounts.
    - Unexplained inventory shrinkage over consecutive months.

    Considering the above, you are appointed by MF Ltd. to evaluate the options for verifying the process to reveal fraud and the corrective action to be taken. As an investigating accountant what will be your areas of verification and the procedure to be followed for verification of defalcation of inventory?

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

19. Sukaran Ltd., a leading textile manufacturing company, has been facing criticism from its employees regarding various workplace concerns. Some employees have raised issues about delayed salary payments, while others have reported excessive working hours that affect their work-life balance. Additionally, a few workers have complained about inadequate safety measures in the factory, leading to frequent minor accidents. Which principle of BRSR deals with this? Mention the core elements of this principle.

Professional Ethics & Liabilities of Auditors (New)

20. (a) KB and Associates are appointed as Statutory Auditors of the Iron Company Ltd. The Central Government holds 72% of the paid-up share capital in this company. The appointment letter of the company gave a very limited time to KB and Associates for accepting the audit. CA Yash, the engagement partner, communicated with the previous auditor but due to lack of time he had to give acceptance for the audit assignment before receiving a reply from the previous auditor. Hence CA Yash gave a conditional acceptance of the appointment and commenced the audit. Discuss with reference to the Chartered Accountants Act, 1949 and the schedules thereunder, whether CA Yash has complied with same.

    (b) If CA Yash is guilty of misconduct in the above situation given in part (a), then before which authority, the matters of CA Yash would have been placed and what punishment could have been imposed on him by the said authority in accordance with the Chartered Accountants Act, 1949?

SUGGESTED ANSWERS/HINTS

PART A: Answers to Multiple Choice Questions

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

PART B: Answers to Descriptive Questions

9. **Relying on Work Performed by Another Auditor**: As per SA 220 "Quality Control for an Audit of Financial Statements", an engagement partner taking over an audit during the engagement may apply the review procedures such as the work has been performed in accordance with professional standards and regulatory and legal requirements; significant matters have been raised for further consideration; appropriate consultations have taken place and the resulting conclusions have been documented and implemented; there is a need to revise the nature, timing and extent of work performed; the work performed supports the conclusions reached and is appropriately documented; the evidence obtained is sufficient and appropriate to support the auditor's report; and the objectives of the engagement procedures have been achieved.

   Further, as per the Code of Ethics it is the auditor's professional responsibilities and should be complied with that when the auditor delegates work to assistants or uses work performed by other auditors and experts, he will continue to be responsible for forming and expressing his opinion on the financial information. However, he will be entitled to rely on work performed by others, provided he exercises adequate skill and care and is not aware of any reason to believe that he should not have so relied.

However, the auditor should carefully direct, supervise and review the work delegated. He should obtain reasonable assurance that work performed by other auditors/experts and assistants is adequate for his purpose.

In the given case, all the auditing procedures before the moment of signing of final report have been performed by CA Jin. However, the report could not be signed by him due to his unfortunate death. Later on, CA Kushal signed the report relying on the work performed by CA Jin. Here, CA Kushal is allowed to sign the audit report, though, will be responsible for expressing the opinion. He may rely on the work performed by CA Jin provided he further exercises adequate skill and due care and review the work performed by him.

10. **Positive confirmation request:** A request that the confirming party respond directly to the auditor indicating whether the confirming party agrees or disagrees with the information in the request or providing the requested information.

Exception – A response that indicates a difference between information requested to be confirmed, or contained in the entity's records, and information provided by the confirming party. The exception needs to be assessed to the entire population after analyzing the reason for difference.

In the given situation, the auditor has sent the positive confirmation request for the amount of ₹ 15,50,000 to a debtor which was outstanding for more than 6 months, however, due to difference between information requested to be confirmed, or contained in the entity's records (i.e. ₹ 15,50,000), and information provided by the confirming party (i.e. ₹ 14,90,000) is forming situation of exception confirmation.

The auditor's evaluation, when taken into account with other audit procedures the auditor may have performed, may assist the auditor in concluding whether sufficient appropriate audit evidence has been obtained or whether performing further audit procedures is necessary, as required by SA 330 in case a response is indicating an exception.

The company should be asked to investigate and reconcile the discrepancy indicated by the confirming party.

Negative confirmation request – A request that the confirming party respond directly to the auditor only if the confirming party disagrees. In the given case, the auditor has sent the negative confirmation request for ₹ 13,25,000 to a creditor. Non- response by the creditor implies that creditor agrees with the amount. Thus, an auditor is not required to take any action in this case.

11. (a) As per SA 580, "Written Representations", the auditor shall request management to provide a written representation that it has fulfilled its responsibility for the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation, as set out in the terms of the audit engagement.

Further, the auditor shall request management to provide a written representation that:

(i) It has provided the auditor with all relevant information and access as agreed in the terms of the audit engagement

(ii) All transactions have been recorded and are reflected in the financial statements.

In the given case, Fun Journey Ltd. refuses to provide a written representation letter, despite the auditor's several requests. Thus, in view of above the contention of auditor is correct.

(b) The written representations as per SA 580, shall be in the form of a representation letter addressed to the auditor. If law or regulation requires management to make written public statements about its responsibilities, and the auditor determines that such statements provide some or all of the representations required, the relevant matters covered by such statements need not be included in the representation letter.

(c) As per SA 580, if management does not provide one or more of the requested written representations, the auditor shall:

(i) Discuss the matter with management;

(ii) Re-evaluate the integrity of management and evaluate the effect that this may have on the reliability of representations (oral or written) and audit evidence in general; and

(iii) Take appropriate actions, including determining the possible effect on the opinion in the auditor's report in accordance with SA 705 (Revised).

Furthermore, the auditor shall disclaim an opinion on the financial statements in accordance with SA 705 (Revised) if the auditor concludes that there is sufficient doubt about the integrity of management such that the written representations required are not reliable or management does not provide the written representations required.

Thus, refusal to provide a written representation could impact the auditor's ability to obtain sufficient appropriate audit evidence, potentially leading to a modified audit report.

12. (a) Reporting responsibility of the auditor under paragraph 3 of CARO, 2020: The auditor is required to report as per clause (vii) (a) of Paragraph 3 of CARO, 2020 that whether the company is regular in depositing undisputed statutory dues including Goods and Services Tax, provident fund, employees' state insurance, income tax, sales-tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues to the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as on the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated;

Further, the auditor is also required to report as per Clause (vii) (b) of Paragraph 3 of CARO, 2020, where statutory dues referred to in sub-clause (a) have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned (a mere representation to the concerned Department shall not be treated as a dispute).

In the given case, Relon Limited has an outstanding Income-tax liability of ₹ 15 lakhs since July 2023. Although the management has filed an objection letter, no formal dispute has been raised, and the dues remain unpaid for more than six months.

Therefore, the auditor is required to report the same under clause (vii)(a) of Para 3 of CARO, 2020.

(b) As per clause (3)(ii)(a) of CARO, 2020, the auditor is required to report whether any discrepancies of 10% or more in the aggregate for each class of inventory were noticed on physical verification conducted by management and if so, whether they have been properly dealt with in the books of account.

Computation of % of discrepancies found in physical verification and Books of Accounts

Particulars	As per physical verification	As per books of accounts	Change
Raw material	1,160	1,180	Less than 10%
Work-in-progress	410	430	Less than 10%
Finished goods	2,500	2,790	More than 10%
Stores and spares	220	180	More than 10%

Since, the discrepancies in the value of finished goods and stores and spares exceed the 10% threshold specified under clause (3)(ii)(a) of CARO, 2020, the auditor should report these discrepancies accordingly.

13. (i) As per SRS 4410, "Compilation Engagements", financial information that is the subject of a compilation engagement may be required for various purposes including:

- To comply with mandatory periodic financial reporting requirements established in law or regulation, if any or
- For purposes unrelated to mandatory financial reporting under relevant law or regulation, including for example:

- For management or those charged with governance, prepared on a basis appropriate for their particular purposes (such as preparation of financial information for internal use).
- For periodic financial reporting undertaken for external parties under a contract or other form of agreement (such as financial information provided to a funding body to support provision or continuation of a grant).
- For transactional purposes, for example, to support a transaction involving changes to the entity's ownership or financing structure (such as for a merger or acquisition).

(ii) The practitioner's report issued for the compilation engagement shall be in writing, and shall include the following elements: -

(a) The report title;

(b) The addressee(s), as required by the terms of the engagement;

(c) A statement that the practitioner has compiled the financial information based on information provided by management;

(d) A description of the responsibilities of management, or those charged with governance as appropriate, in relation to the compilation engagement, and in relation to the financial information;

(e) Identification of the applicable financial reporting framework and, if a special purpose financial reporting framework is used, a description or reference to the description of that special purpose financial reporting framework in the financial information;

(f) Identification of the financial information, including the title of each element of the financial information if it comprises more than one element, and the date of the financial information or the period to which it relates;

(g) A description of the practitioner's responsibilities in compiling the financial information, including that the engagement was performed in accordance with this SRS, and that the practitioner has complied with relevant ethical requirements;

(h) A description of what a compilation engagement entails in accordance with this SRS;

(i) **Explanations that: -**

 (i) Since a compilation engagement is not an assurance engagement, the practitioner is not required to verify the accuracy or completeness of the information provided by management for the compilation; and

 (ii) Accordingly, the practitioner does not express an audit opinion or a review conclusion on whether the financial information is prepared in accordance with the applicable financial reporting framework.

(j) If the financial information is prepared using a special purpose financial reporting framework, an explanatory paragraph that:

 (i) Describes the purpose for which the financial information is prepared and, if necessary, the intended users, or contains a reference to a note in the financial information that discloses this information; and

 (ii) Draws the attention of readers of the report to the fact that the financial information is prepared in accordance with a special purpose framework and that, as a result, the information may not be suitable for other purposes;

(k) The date of the practitioner's report;

(l) The practitioner's signature; and

(m) The place of signature.

14. The type of phishing cyberattack Yuvi fell victim to is Smishing. It is a type of fraudulent practice of sending text messages purporting to be from reputable companies in order to induce individuals to reveal personal information, such as passwords or credit card numbers.

Other types of phishing cyberattacks are:

Spear Phishing: It is a type of phishing attack that targets specific individuals or organizations typically through malicious emails. The goal of spear phishing is to steal sensitive information such as login credentials or infect the targets' device with malware.

Whaling: A whaling attack is a type of social engineering attack specifically targeting senior or C-level executive employees with the purpose of stealing money or information or gaining access to the person's computer in order to execute further cyberattacks.

Vishing: Vishing, a voice phishing attack, is the fraudulent use of phone calls and voice messages pretending to be from a reputable organization to convince individuals to reveal private information such as bank details and passwords.

15. According to Section 129(3) of the Companies Act, 2013, where a company has one or more subsidiaries, including associate company and joint venture, it shall, in addition to its own financial statements prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and manner as that of its own.

As per sub-section 6 of section 129 of the Companies Act, 2013, the Central Government may, on its own or on an application by a class or classes of companies, by notification, exempt any class or classes of companies from complying with any of the requirements of section 129 or the Rules made thereunder.

An investment entity is an entity that:

(a) obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services;

(b) commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and

(c) measures and evaluates the performance of substantially all of its investments on a fair value basis.

An investment entity needs not present consolidated financial statements if it is required, in accordance with paragraph 31 of Ind AS 110, to measure all of its subsidiaries at fair value through profit or loss. A parent shall determine whether it is an investment entity.

However, as per paragraph 33 of Ind AS 110, Parent of an investment entity shall consolidate all entities that it controls, including those controlled through an investment entity subsidiary, unless the parent itself is an investment entity.

Applying the above to the given case of Advik Investments Ltd., which fulfils all the conditions stated above, it is an investment entity. By applying Para 31 and 33 of Ind AS 110, it can be concluded that Advik Investments Ltd. is not required to consolidate as per Section 129 (3) of the Companies Act, 2013.

16.

Sr. No.	**Reason for such Query**	**Action that may be taken in response to the query**
1.	In case of sale of NPA, where the sale is for a value higher than the NBV, the auditor is required to ensure that no profit is recognized, and the excess provision has not been reversed but retained to meet the shortfall/ loss that may arise because of the sale of other non-performing financial assets.	The entry for reversal of the excess provision would be cancelled in the books and such excess provision would be retained to meet the shortfall/ loss that may arise because of the sale of other non-performing financial assets.
2.	A State Government Guaranteed advance has to be treated as NPA even if it remains overdue for more than 90 days and in case of NPA, for the purpose of income	Interest income recognized on such advance would be reversed and would be taken to income only when

	recognition, interest on such advance should not be taken to income unless interest is realized.	it is realized.
3.	Accounts for which the ad hoc limit has not been reviewed for 180 days from the date of such ad hoc sanction, should be considered as NPA.	Its treatment in the books would be changed from performing asset to a non-performing asset from the date when such change in the treatment was required.
4.	Net position in respect of each of the foreign currencies should be generally squared and should not be uncovered by a substantial amount.	The net "position" of the branch in relation to each foreign currency should be squared off and get covered by a substantial amount.
5.	Additional temporary limits may be sanctioned, for a maximum of 20% of the existing limit and 90 days maximum tenure.	The terms of additional temporary limit in the case of such account would be revised to 20% of the existing limit and for 90 days maximum tenure.

17. In the given situation, Performance Audit will be conducted as it is an objective and systematic examination of evidence for the purpose of providing an independent assessment of the performance of a government organization, program, activity, or function in order to provide information to improve public accountability and facilitate decision-making by parties with responsibility to oversee or initiate corrective action.

Some of the methods which could be used in conducting performance audits include:

(i) Analysis of procedures: It involves review of the systems in place for planning, conducting, checking and monitoring the activity.

This would consist of examination of documents such as financial reports, budgets, programme guidelines, procedure manuals, etc.

(ii) Case studies: A case study is a descriptive analysis of an entity, scheme or a programme. It involves analysis of a particular issue within the context of the whole area under review.

(iii) Use of existing data: The audit staff should investigate the data held by entity management and by other relevant sources. Audit conclusions based on testing of available data for correctness and completeness enhances the assurance level.

(iv) Surveys: Survey is a method of collecting information from members of a population to assess the interrelation of events and conditions. Surveys on predetermined parameters can supplement the audit findings and conclusions adding value to the performance audits.

(v) Analysis of results: It requires the auditor to carry out actual output-input analysis to determine the efficiency of the programme.

(vi) Quantitative analysis: It involves examination of available data relating to financials like earnings, revenue, or data relating to programme implementation like details of beneficiaries etc. However, it may not be possible for the auditor to work with complete data due to its high volume. In such cases, sampling techniques are required to be used.

18. Inventory Frauds - Inventory frauds are many and varied but here we are concerned with misappropriation of goods and their concealment.

(i) Employees may simply remove goods from the premises.

(ii) Theft of goods may be concealed by writing them off as damaged goods, etc.

(iii) Inventory records may be manipulated by employees who have committed theft so that book quantities tally with the actual quantities of inventories in hand.

(iv) Inflating the quantities issued for production is another way of defalcating raw materials and store items.

(v) Stocks actually dispatched but not entered in sales/ debtor's account.

Verification Procedure for Defalcation of inventory - It may be of trading stock, raw materials, manufacturing stores, tools or of other similar items (readily) capable of conversion into cash. The loss may be the result of a theft by an employee once or repeatedly over a long period, when the same have not been detected. Such thefts usually are possible through collusion among a number of persons. Therefore, for their detection, the entire system of receipts, storage and dispatch of all goods, etc. should be reviewed to localise the weakness in the system.

The determination of factors which have been responsible for the theft and the establishment of guilt would be difficult in the absence of: (a) a system of inventory control, and existence of detailed record of the movement of inventory, or (b) availability of sufficient data from which such a record can be constructed. The first step in such an investigation is to establish the different items of inventory defalcated and their quantities by checking physically the quantities in inventory held and those shown by the Inventory Book. Investigating accountant should ascertain the exact duties of persons handling the stocks received in and issued from store for production/ sale or any other purpose. Identify the excessive control in the hands of a single person, without any supervision as it will widen the scope of investigation.

Afterwards, all the receipts and issues of inventory recorded in the Inventory Book should be verified by reference to entries in the Goods Inward and Outward Registers and the documentary evidence as regards purchases and sales. This would reveal the particulars of inventory not received but paid for as well as that issued but not charged to customers. Further, entries in respect of returns, both inward and outward, recorded in the financial books should be checked with corresponding entries in the Inventory Book. Also, the totals of the Inventory Book should be checked. Finally, the shortages observed on physical verification of inventory should be reconciled with the discrepancies observed on checking the books in the manner mentioned above. In the case of an industrial concern, issue of raw materials, stores and tools to the factory and receipts of manufactured goods in the godown also should be verified with relative source documents.

Defalcations of inventory, sometimes, also are committed by the management, by diverting a part of production and the consequent shortages in production being adjusted by inflating the wastage in production; similar defalcations of inventories and stores are covered up by inflating quantities issued for production. For detecting such shortages, the investigating accountant should take assistance of an engineer. For that he will be more conversant with factors which are responsible for the shortage in production and thus will be able to correctly determine the extent to which the shortage in production has been inflated. In this regard, guidance can also be taken from past records showing the extent of wastage in production in the past. Similarly, he would be able to better judge whether the material issued for production was excessive and, if so to what extent. The per hour capacity of the machine and the time that it took to complete one cycle of production, also would show whether the issues have been larger than those required.

19. Principle 3 – Promote Well-Being of All Employees Including those in the Value Chain: The third principle relates to all the initiatives an entity has to take for the benefit of its employees from the point of view of their dignity, health, well-being.

The essence of the core elements associated with the principle is:

(a) The entity should ensure compliance with all regulatory requirements as far as employees are concerned.

(b) The entities are to respect the dignity of employee as a human being and should not restrict their freedom of associations, unions, and other participatory mechanism for collective bargaining of their rights and redressal of issues they face at the workplace.

(c) The entities should prevent all kinds of child labour, bonded labour, and any other forms of involuntary labour.

(d) The entities should have a system in which the work-life balance of the employees is not compromised.

(e) The businesses have to ensure timely payment of the worker's wages and compensation.

(f) The payment of the wages has to be as per the living wages, that can take care of the basic needs and provide economic security to the employees.

(g) The entities are responsible to create a workplace and work environment that is safe, hygienic, and comfortable for people to work for long durations.

(h) The skill development, career development and training of the workforce is another responsibility of the entities employing them.

(i) The creation of a workplace which is free of harassment and violence is also a responsibility of the entity.

In the given case, employees have raised issues about delayed salary payments, excessive working hours that affect their work-life balance and complained about inadequate safety measures in the factory.

In view of the above, Sukaran Ltd. must take corrective actions to align with this principle.

20. **(a)** As per Clause (8) of Part I of First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he accepts a position as auditor previously held by another chartered accountant or a certified auditor who has been issued certificate under the Restricted Certificate Rules, 1932 without first communicating with him in writing.

Although the mandatory requirement of communication with previous auditor being Chartered Accountant applies, in uniform manner, to audits of both government and Non-Government entities, yet in the case of audit of government Companies/ banks or their branches, if the appointment is made well in time to enable the obligation cast under this clause to be fulfilled, such obligation must be complied with before accepting the audit. However, in case the time schedule given for the assignment is such that there is no time to wait for the reply from the outgoing auditor, the incoming auditor may give a conditional acceptance of the appointment and commence the work which needs to be attended to immediately after he has sent the communication to the previous auditor in accordance with this clause. In his acceptance letter, he should make clear to the client that his acceptance of appointment is subject to professional objections, if any, from the previous auditors and that he will decide about his final acceptance after taking into account the information received from the previous auditor.

In the given case, KB and Associates are appointed as Statutory Auditors of the Iron Company Ltd. which is a government company as Central Government holds 72% of the paid-up share capital of the company and CA Yash has given a conditional acceptance of the appointment and commenced the audit. In view of the above, it can be concluded that CA Yash is not liable for misconduct and has complied with the provisions of the Chartered Accountants Act, 1949 and the Schedules thereunder.

(b) If CA Yash would have been found guilty of professional misconduct under Clause 8 of Part I of the First Schedule of the Chartered Accountants Act, 1949: The matter would have been placed before the Board of Discipline. The punishment that the Board of Discipline could have imposed would be:

(i) Reprimand the member.

(ii) Remove the name of the member upto a period of 3 months.

(iii) Impose fine upto rupees ₹ 1,00,000/-.

Applicability of Standards / Guidance Notes / Legislative Amendments etc. for May, 2025 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.	**Application of Indian Accounting Standards (Ind AS) with reference to General Purpose Financial Statements** (iv) Ind AS on Assets and Liabilities of the Financial Statements	**Indian Accounting Standard (Ind AS) 16 'Property, Plant and Equipment'** • Appendix B- Stripping Costs in the Production Phase of a Surface Mine **Indian Accounting Standard (Ind AS) 37 'Provisions, Contingent Liabilities and Contingent Assets'** • Appendix A: Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds • Appendix B: Liabilities arising from Participating in a Specific Market — Waste Electrical and Electronic Equipment
	(vii) Other Ind AS	• Indian Accounting Standard (Ind AS) 29: Financial Reporting in

		Hyperinflationary Economies • Indian Accounting Standard (Ind AS) 106 : Exploration for and Evaluation of Mineral Resources • Indian Accounting Standard (Ind AS) 114 : Regulatory Deferral Accounts • Indian Accounting Standard (Ind AS) 117 : Insurance Contracts

(II) Important Points for Consideration

(1) November, 2024 edition of the Study Material is relevant for May, 2025 examination.

(2) The relevant Amendments / Notifications / Circulars / Rules issued by the Companies Act, 2013 and Limited Revisions in existing standards, issued up to 31st October, 2024 will be applicable for May, 2025 Examination.

(3) Newly notified Ind AS becomes applicable only one year after their notification. Accordingly, Ind AS 117: Insurance Contracts notified on 12th August, 2024 will not be applicable for May, 2025 Examination. However, limited revisions in the existing applicable Ind AS consequent to notification of Ind AS 117 will be applicable in May, 2025 examination.

(3) 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.

Paper 3: Advanced Auditing, Assurance and Professional Ethics

I. Applicability of Revised SA 800, "Special Considerations-Audits of Financial Statements Prepared in Accordance with Special Purpose Framework", Revised SA 805, "Special Considerations-Audits of Single Purpose Financial Statements and Specific Elements, Accounts or Items of a Financial Statement" and Revised SA 810, "Engagements to Report on Summary Financial Statements" covered in Chapter 8 Specialised Areas for May, 2025 Examination.

II. Applicability of the Legislative Amendments for May, 2025 Examination: Students are expected to be updated with the notifications, circulars and other legislative amendments made up to 6 months prior to the examination. Accordingly, the relevant notified Sections and legislative amendments including relevant Notifications / Circulars / Rules / Guidelines issued by Regulating Authority up to October 31st, 2024 will be applicable for May, 2025 Examination.

Note: Revised Chapter 8 and significant notifications and circulars issued applicable for May, 2025 Examinations are covered in the November 2024 edition of Study Material.