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Further, in the Elective Papers which are Case Study based, the solutions have been worked out on the basis of certain assumptions/views derived from the facts given in the question or language used in the question. It may be possible to work out the solution to the case studies in a different manner based on the assumption made or view taken.

PAPER – 6F: MULTI-DISCIPLINARY CASE STUDY

The question paper comprises three case study questions. The candidates are required to answer any two case study questions out of three.

All your workings should form part of your answer.

CASE STUDY -1 :

Background:

You are a recently appointed audit partner in a large independent firm of Chartered Accountants ("the Firm") based out of Chennai which has a variety of clients engaged in various growth sectors of the economy. You are delighted that you are now a partner and cannot wait to sign off your first set of accounts. Your firm was recently appointed as the Statutory Auditors of a large, family owned, listed Company, M/s. Anju Texyarn Limited (ATL) (the Company) at the Annual General Meeting of the Company held on 29th September, 2018 to audit the accounts of the Company for the FY 2018-19. The Audit firm's Managing Partner, Mr. Kumar has allocated the client to you to conduct the audit. The Managing Partner is reasonably close to the family which owns the Company and you believe that this is at least part of the reason why the Company decided to appoint your firm. Mr. Kumar made a short presentation of the Company as under:

Company Information :

The Company was originally incorporated as Anjana Textiles (CBT) Private Limited on 1st April, 2007 under the provisions of the erstwhile Companies Act, 1956 having their Registered Office at Chennai, South India. The Company was subsequently converted into a Public Limited Company on 1st April, 2009 and the Certificate for commencement of business was also obtained. The name of the Company was subsequently changed to Anju Texyarn Limited on 1st April, 2010. ATL commenced commercial operations in the year 2011. The Company's shares were listed at National Stock Exchange of India Limited (NSE) in April, 2014.

ATL is a part of the Chennai based Kamatchi Amman Group, which is involved in manufacturing, trading and distribution activities. The group has business interests in sugar, textiles, food processing, transportation, distillery, automobile distribution, healthcare, etc. with a turnover of over ₹ 16,000 million and net worth of about ₹ 8,000 million. All the manufacturing facilities are located in South India. As on 31st March, 2019, ATL has two factories housed around 2.85 lakh square feet in Tamil Nadu. The spinning division in Dindigul, Tamil Nadu has an installed capacity of 40,000 spindles, producing around 22 tonnes of cotton yarn per day. The weaving division located in Coimbatore, Tamil Nadu, has an installation of 40 Sulzer projectile machines. The export sales constituted 24% of total revenue as on 31st March, 2019. Furthermore, in May 2018 the Company was awarded a Certificate of Recognition as an Export House by the Joint Director General of Foreign Trade.

As on date, ATL has evolved to be a significant player in cotton yam spinning in South India, commanding a premium in the market for their products having a strong domestic presence in Tirupur, Kanpur and Kolkota markets and exported their products to several countries including Israel, Mauritius, Egypt, Taiwan and South Korea. ATL's strategy is to expand their existing capacity in spinning and weaving, as well as enter other areas in the textile chain including processing and garmenting/home textiles. Their vision is to achieve excellence in all sectors of the textile industry, from fibre to finished product, constantly striving to be at the forefront of the industry and to generate highest possible value to all stakeholders.

The Vice President (Finance and Accounts) of the Company, Mr. Narayanan made available to you the summary of financial highlights (audited) for the financial years 2015-16 to 2017-18 and also presented the summary of unaudited financial highlights for the financial year 2018-19 and informed you that the summary of financials as at 31st March, 2019 was prepared subject to audit of certain items that need clarifications and resolutions from the Statutory Auditors.

Summary of Statement of Profit and Loss :

(₹ In Crores)

Particulars	*Year Ended 31.03.2019 (Unaudited)*	*Year Ended 31.03.2018 (Audited)*	*Year Ended 31.03.2017 (Audited)*	*Year Ended 31.03.2016 (Audited)*
Net Sales	900	800	732	597
Income from Windmill	40	30	25	20
Other Income	15	14	12	10
Increase/(Decrease) in Stock	23	17	11	9
Total	**978**	**861**	**780**	**636**
Expenditure :				
Raw Material Consumed	720	640	585	478
Employee Cost	27	24	22	18
Power and Fuel	72	65	60	48
Other Manufacturing Cost	36	32	30	24
Administrative Expenses	14	13	11	9
Selling and Distribution Expenses	22	20	18	15
Interest	14	13	12	11
Depreciation	30	27	25	23
Total	**935**	**834**	**763**	**626**

Net Profit before Extra-Ordinary Items and Tax	*43*	*27*	*17*	*10*
Current Tax (Provision and Payment)	*12*	*8*	*5*	*3*
Deferred Tax	*5*	*2*	*(1)*	*1*
Net Profit After Tax	*26*	*17*	*13*	*6*

Share Capital and Net Worth: ***(₹ In Crores)***

Particulars	***Year Ended 31.03.2019 (Unaudited)***	***Year Ended 31.03.2018 (Audited)***	***Year Ended 31.03.2017 (Audited)***	***Year Ended 31.03.2016 (Audited)***
Equity Share Capital	*125*	*125*	*125*	*125*
Reserves and Surplus	*335*	*328*	*324*	*320*
Net Worth	*460*	*453*	*449*	*445*

You have taken charge of the assignment and requested Ms. Pratibha, the Senior Audit Manager to support you on this assignment. Initially, you go through all the firm's new client procedures which include writing to the previous auditors and also obtaining sets of audited accounts for the previous 3 years from the Company.

When you receive the written reply from the previous auditors, you note that they have nothing to report other than any matters addressed in their audit report. On a review of the Company's financial statements for the previous year, you note that the Company's audit report was qualified on the basis of non-compliance with an Accounting Standard. The audit report highlights that the Company owns a property and on cost grounds, decided not to have a valuation performed. The audit opinion adds that the auditor is unable to quantify the impact of this non-compliance with the accounting standard. You wish that you had access to the working papers of the predecessor auditors but you are informed that it is not possible.

You are considering the impact of this issue when Mr. Kumar, the Managing Partner, comes into your office. He provides you again with an oral briefing on ATL and then asks you whether you have any queries. You inform Mr. Kumar what you have found. Mr. Kumar replies: I do not see any problems; if the client does not believe that it is worth paying for this information then who are we to tell them otherwise: it is a family business after all. If we have to, we can adopt the same approach as the previous auditors and qualify the audit report on the same grounds."

That is when you inform him that you have doubts as to whether the audit qualification issued was appropriate in the circumstances. The previous auditors issued an except for – disagreement with accounting treatment – due to non-compliance with an accounting standard" and you believe that a "limitation of scope" opinion may have been more appropriate. You are not sure but you surmise that this may be because of the requirement that if a client places a *limitation of scope on the work of the auditors which will require the auditor to issue a disclaimer of opinion, in advance of the auditors accepting that appointment, then unless the restriction is removed, the auditor should not continue in office for that particular client. Mr. Kumar replies that you should go ahead and reassess the position once the audit fieldwork has been completed by your team.*

Since you are not bound to compromise anything either on the audit process nor your Independence and at the same time keeping in mind the relationship of Mr. Kumar, you have decided to balance the situation with an appropriate presentation and pointing out the legal position to avoid/rectify any lapse or short comings, to the satisfaction of both the management of the Company and your Managing Partner.

Accordingly, you have made a detailed Audit program and asked your Audit engagement team to look meticulously into every material aspect and conduct the audit for the financial year 2018-19 from the propriety angle.

The engagement team led by Ms. Pratibha has reported the following matters to you based on their field audit. You think that the observations noted, if not dealt with properly, would impact the true and fair view of the financial statements and accordingly you have instructed your audit team to analyse and briefly provide the basis for assessment.

(a) The Company had created a separate Trust called "Anju Texyarn Limited Employees Gratuity Fund Trust". Both the Company and the Trust are under the same Management. You observed that during the previous year, some part of the expenditure was not applied towards the objects of the Trust and the previous Auditor had informed the matter to the Board of Trustees through a separate report but did not qualify the Audit Report of the Trust;

(b) For the financial year ended 31st March, 2018, it was observed that the previous auditors signed their audit report on 4th May, 2018. The Annual General Meeting was held on 29th September, 2018. On 6th May, 2018 the Company received a communication from the Central Government that an amount of ₹ 150 crore kept pending on account of export incentives pertaining to financial year 2017-18 had been approved and the amount would be paid to the Company before the end of May 2018. This amount was initially not recognized in the audited financial statements in view of the same not being released before the close of the financial year and due to uncertainty of receipt. Now, having received the amount, the Board of Directors wished to include this amount in the financial statements of the Company for the financial year ended on 31st March, 2018 and accordingly, on 8th May, 2018, the Board amended the accounts, approved the same and requested the Auditors consider this event and issue a fresh Audit Report on the financial statements for the year ended on 31st March, 20l8. Accordingly, the previous Auditors issued a fresh Audit report;

(c) *Provision for payment of gratuity was not made during the last three years for employees who have not completed the stipulated period of service. In this regard, Mr. Narayanan informed that in view of the attrition rate among employees, it was thought prudent to quantify the gratuity liability and disclose the non-provision in the notes on accounts and recognize the same in the year of payment at which point only the liability arises;*

(d) *The Company received a grant of ₹2 crores from the Central Government for the purchase of a special Machinery during financial year 2014-15. The cost of Machinery was ₹ 20 crores and had a useful life of 9 years. During the financial year 2018-19, the grant has become refundable due to non- fulfillment of certain conditions attached to it. The entire grant was deducted from the cost of Machinery in the year of acquisition.*

(e) *On a perusal of the secretarial records including the minutes of the Board Meetings and Audit Committee Meetings, the audit team observed that:*

(i)	*The Company's Board consists of 10 directors including a non- executive director as its Chairman;*
(ii)	*The internal audit reports were received by the Audit Committee on a quarterly basis. Quarter 3 internal audit report commented on certain irregularities as regards electronic on line auction of scrap. The Agenda of the Audit Committee did not deliberate or take note of the issue;*
(iii)	*There were four Independent Directors on the Board. One of them resigned on 25th May, 2018. A new Independent Director was appointed on 1st September, 2018;*
(iv)	*There were five Audit Committee meetings held during the year as follows : 1st April, 2018, 1st June, 2018, 1st September, 2018, 3rd January, 2019 and 25th March,2019.*

(f) *The Company availed a lease from N & S Ltd. The conditions of the lease terms are as under:*

(i)	*Lease period is 3 years, in the beginning of the year 2016, for an equipment costing ₹ 10,00,000 and has an expected useful life of 5 years;*
(ii)	*The Fair market value is also ₹ 10,00,000;*
(iii)	*The property reverts back to the lessor on termination of the lease;*
(iv)	*The unguaranteed residual value is estimated at ₹ 1,00,000 at the end of the year 2018;*
(v)	*3 equal annual payments are made at the end of each year. At an INR = 10%, the present value of ₹ 1 due at the end of 3rd year at 10% rate of interest is ₹0.7513. The present value of annuity of ₹1 due at the end of 3rd year at 10% IRR is ₹ 2.4868*

(g) Joe Weider Incorporation, a non-resident Company has an IT enabled business process outsourcing unit in India (BPO) and it provides certain outsourcing services to ATL being a resident Indian entity;

(h) The Company has a track record of maintaining consistent dividend payment of a minimum of 14%. In the financial year 2017-18, the Board, in order to conserve the funds for future operations, decided not to declare dividend for FY 2017-18 and as a consequence, it was not possible for the Company to maintain the payment of consistent dividend as above. The Management felt that for the financial year 2018-19, the depreciation of the year to the extent of 75% alone be charged to the Statement of Profit and Loss and the remaining 25% be kept in a separate account code in the Balance Sheet - 'Debit Balances Adjustable against Revenue account'. The Management was of the view that it would be unfair practice of accounting if the depreciation for assets is charged before the expiry of the life of assets and the amount parked in asset code as above would anyway be adjusted to Revenue before the close of next financial year;

(i) The Company sold some equipments through. its dealers. One of the conditions at the time of sale is, payment of consideration in 14 days and in the event of delay, interest chargeable @ 15 per annum. The Company has not realized interest from the dealers in the past. However, for the year ended 31st March, 2019, it wants to recognize interest due on the balances due from dealers. The amount is ascertained at ₹ 9 lakhs;

(j) The Company purchased goods at the cost of ₹ 40 Lakhs in October, 2018. Till March, 2019, 75% of the stocks were sold. The Company wants to disclose closing stock at ₹ 10 Lakhs as at 31st March, 2019. The expected sale value is ₹ 11 Lakhs and a commission at 10% on sale is payable to the agent.

(k) The Company could not recover ₹ 10 lakhs from a debtor. The Company is aware that the debtor is in great financial difficulty. The accounts of the Company were finalized for the year ended 31st March, 2019 by making a provision @ 20 of the amount due from the said debtor. The debtor became bankrupt in April, 2019 and nothing is recoverable from him;

(l) The Company undertook a construction contract for ₹ 50 crores in April, 2018. The cost of construction was initially estimated at ₹ 35 crores. The contract is to be completed in 3 years. While executing the contract, the Company estimated the cost of completion of the contract at ₹ 53 crores;

(m) The Property, Plant and Equipment of the Company included ₹ 75 lakhs of earth moving machines of outdated technology that has been retired from actual use and has been kept for disposal as scrap after its knock down. This machine appeared at residual value and had been last inspected 8 years back;

(n) As a part of the business, the Company supplies water drawn from its land by pumping out the water and through a water course constructed by it to the nearby villages whereby the water is allowed to be used by the villagers for drinking purposes. The cost of construction of water course was ₹ 3 Crores and the Company had disclosed this amount as CSR expenses in the draft Statement of Profit and Loss as at 31st March, 2019;

(o) *Goods worth ₹ 15 Lakhs were destroyed due to fire in September 2017. A claim was lodged with the Insurance Company. But no entry was passed in the books for insurance claim in the financial year 2017-18. In March, 2019, the claim was passed and the Company received a payment of ₹ 13.50 Lakhs;*

(p) *The Company created a provision for bad and doubtful debts @ 2.5% on debtors while preparing the draft financial statements for the financial year 2018-19. Subsequently on a review of the credit period allowed and the financial capacity of the customer, the Company decided to increase the provision to 8% on debtors as on 31st March, 2019;*

(q) *The Company made an annual budget of ₹ 3.50 crores for extensive special initial advertisement campaign for marketing a new product and estimated that the Company would have a turnover of ₹ 45 crores from the new product. The Company had debited to its Statement of Profit and Loss, the total expenditure of ₹ 3.50 crores incurred on such advertisement campaign for the new product;*

(r) *As at 31st March, 2019, an Inter-Corporate deposit of ₹ 200 Lakhs given to ABC Ltd. has become overdue. The Company has disclosed this fact in the notes to accounts stating that ₹ 200 Lakhs is overdue from ABC Ltd and the said Company is in the process of liquidation and the management is taking steps to appoint a liquidator.*

Now, you are under a precarious situation whereby you have to deal and address the open accounting matters as enumerated above and revert to the firm's Managing Partner and going forward to deliberate with the Chairman of the Audit Committee and the top Management of the Company including their Key Managerial Personnel. Based on the above, answer the following questions:

Answer the following questions:

1.1. *As per Ind AS 18*, income by way of interest from dealers is :*

(A) *Not eligible for recognition;*

(B) *Eligible for recognition;*

(C) *Interest element does not form part of the sales;*

(D) *None of the above.*

1.2. *The value of closing stock as per Ind AS 2 as on 31st March, 2019 should be:*

(A) *₹ 10 Lakhs;*

(B) *₹ 9 Lakhs*

(C) *₹ 9.90 Lakhs;*

(D) *₹ 9.50 lakhs.*

* Read 'Ind AS 18'as 'Ind AS 115'.

1.3. On the debtor becoming bankrupt, the Company should:

(A) Provide the entire sum of ₹ 10 lakhs as non-recoverable as at 31st March, 2019;

(B) Provide the entire sum of ₹ 10 lakhs as non-recoverable as at 31st March, 2020;

(C) Provide ₹ 8 lakhs as non-recoverable as at 31st March, 2019;

(D) Provide ₹ 8 lakhs as non-recoverable as at 31st March, 2020.

1.4. In respect of the construction contract, the Company :

(A) Should provide for the expected loss in the books of accounts for the year ended 31st March, 2019;

(B) Should provide for the expected loss in the books of accounts over a period of three years being the tenure of the contract;

(C) Should not recognize as an expense the expected loss;

(D) None of the above.

1.5 In the light of the information provided in para (m) above, the Auditor:

(A) Need not disclose in his Audit Report as per CARO, 2016 as the machines have become of outdated technology and fully retired from active use;

(B) Need to disclose in his Audit Report as per CARO, 2016 even if the machines have become of outdated technology and fully retired from active use;

(C) Need not disclose in his Audit Report as per CARO, 2016 but a disclosure of such fact needs to be done in the Notes on Accounts;

(D) Does not come under the purview of CARO, 2016.

1.6 The cost of construction of water course was ₹ 3 crores and the Company had disclosed this amount as CSR expenses in the draft Statement of Profit and Loss as at 31st March, 2019. This accounting treatment is:

(A) Not correct as this expense is incurred in the normal course of business and therefore cannot be claimed as CSR activity;

(B) Correct as water is supplied to the villagers for drinking purposes. Hence, it amounts to a CSR activity;

(C) The expenses incurred on water course is a capital expenditure and therefore needs to be capitalized and disclosed in the Balance Sheet and further it will not be a CSR activity;

(D) The expenses on water course has to be amortized over the useful life of the asset and cannot be claimed as CSR activity.*

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* PS: Read 'amortized' as 'depreciated'.

1.7 The treatment of receipt of insurance claim in the financial statements for the year ended 31st March 2019, as per Ind AS 8 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies":

(A) Should be accounted and disclosed separately as a prior period item;

(B) Should be accounted and disclosed as a current period item due to its receipt in the current accounting year;

(C) Should not be accounted and disclosed but be qualified by the Auditor;

(D) Should not be accounted but disclosed in the notes on accounts as a receipt pertaining to an earlier period.

1.8 How is revision in the estimate of provision for bad and doubtful debts considered as per Ind AS 8 ?

(A) As a prior period item;

(B) As an extraordinary item;

(C) As change of estimate;

(D) None of the above.

1.9 The Company has debited to its statement of profit and loss, the total expenditure of ₹ 3.50 crore incurred on extensive special advertisement campaign for the new product. Pursuant to Ind AS 38 "Intangible Assets":

(A) Accounting treatment is correct as no intangible asset is created that can be recognized;

(B) Accounting treatment is incorrect as an intangible asset is acquired or created that can be recognized as it forms part of the cost of an intangible asset;

(C) Expenditure on advertising and promotional activities are not covered under Ind AS 38;

(D) It is enough if the advertisement expenses are disclosed in the notes on accounts.

1.10 In respect of overdue inter-corporate deposits:

(A) Since the Company is in the process of liquidation, provision for the loss is required to be made in the accounts and the auditor should qualify in his audit report;

(B) No provision for the loss is to be made in the accounts. But, the auditor should qualify in his audit report;

(C) No provision for the loss or compliances of any accounting standard is required since adequate disclosures have been made in the notes on accounts;

(D) The over-due inter-corporate deposit is safe and realizable in full as the Management is taking steps to appoint a liquidator. ***(2 x 10 = 20 Marks)***

PART - B

1.11 In respect of the expenses not applied towards the objects of the Trust referred in a para (a), examine whether the action of the previous Auditor by informing the Board of Trustees through a separate report and not qualifying in the Audit Report of the Trust is in order ? ***(4 Marks)***

1.12 In the light of the information provided in para (b) above, analyze the issues involved and give your views as to whether or not the Auditors could accede to the request of the Board of Directors for issuing a revised Audit Report ? ***(4 Marks)***

1.13 State with reasons, the accounting treatment to be followed in the financial year 2018-19 in respect of refund of government grant due to non-fulfillment of certain conditions attached to it as discussed in para (d) above and pursuant to Ind AS 20. ***(4 Marks)***

1.14 In the light of the certificate of compliance of conditions of Corporate Governance to be issued to a listed entity, give your comments/responses to the situations given in para (e) above. ***(4 Marks)***

1.15 In the light of the information given in para (f) above, state whether the lease constitute a finance lease and also calculate unearned finance income in terms of Ind AS 17.

(4 Marks)

1.16. Discuss the direct tax implications in the hands of Joe Weider Incorporation due to presence of BPO in India. ***(4 Marks)***

1.17 In the light of the information given in para (h) above, analyze the issues involved and state how the Auditor should decide on this matter. ***(4 Marks)***

ANSWER TO CASE STUDY1

PART – A

1.1 (A)

1.2 (C)

1.3 (A)

1.4 (A)

1.5 (B)

1.6 (D)

1.7 (A)

1.8 (C)

1.9 (A)

1.10 (A)

PART – B

1.11 Issuance of Separate Report or Qualified Opinion*:* As per SA 705, "Modifications to the Opinion in the Independent Auditor's Report", the auditor shall express a qualified opinion when:

(i) The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or

(ii) The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

In the instant case, the Company had created a separate trust called, Anju Taxyarn Limited Employees Gratuity Fund Trust, it has been noticed that some part of the expenditure was not applied towards the objects of the Trust, therefore, the previous auditor informed the matter to the Board of Trustee vide a separate report instead of qualifying the audit report of the Trust.

In the given situation, some part of the expenditure was not applied towards the objects of the Trust. Assuming that default amount is individually or in aggregate is not material or material but not pervasive, therefore, action of the previous auditor by informing the Board of Trustees through separate report and not qualifying in the audit report of the Trust is in order.

Alternatively, candidates may be given due credit in case their answer is based on assumption that amount of such expenditure is material but not pervasive, Therefore, the action of the auditor is not correct by issuing separate report to Board of Trustee, he should qualify the Audit Report of the Trust.

Alternative Solution on the basis of the Chartered Accountant Act, 1949

Disclosure of Material Facts: A Chartered Accountant in practice is deemed to be guilty of professional misconduct under Clause (5) of Part I of the Second Schedule if he "fails to disclose a material fact known to him which is not disclosed in a financial statement but disclosure of which is necessary to make the financial statement not misleading". In this case, the Chartered Accountant was aware of the contraventions and irregularities committed by the trust as these were referred to in the separate report given by the Chartered Accountant to the Board of trustees of the company. However, he had issued the audit report without any qualification. On similar facts it was held by the Supreme Court in Kishorilal Dutta vs. P. K. Mukherjee that it was the duty of the Chartered Accountant to have disclosed the irregularities and contravention to the beneficiaries of the fund in the statement of accounts signed by him. Accordingly, in the present case also it has to be held that the Chartered Accountant is guilty of professional misconduct if the amount of irregularities is proved material.

1.12 Facts Which Become Known to the Auditor After the Date of the Auditor's Report but Before the Date the Financial Statements are Issued: As per SA 560, "Subsequent Events", the auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report. However, when, after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall -

(i) Discuss the matter with management and, where appropriate, those charged with governance.

(ii) Determine whether the financial statements need amendment and, if so,

(iii) Inquire how management intends to address the matter in the financial statements.

If management amends the financial statements, the auditor shall carry out the audit procedures necessary in the circumstances on the amendment. Further, the auditor shall extend the audit procedures and provide a new auditor's report on the amended financial statements. However, the new auditor's report shall not be dated earlier than the date of approval of the amended financial statements.

In the instant case, the Company received an amount of rupees 150 crore on account of export incentives pertaining to financial year 2017-18 in the month of May 2018 i.e. after finalisation of financial statements and signing of audit report. Board of Directors amended the accounts, approved the same and requested the auditor to consider this event and issue a fresh audit report on the financial statements for the year ended on 31.03.2018.

After applying the conditions given in SA 560, Auditor can issue new audit report subject to date of audit report which should not be earlier than the date of approval of the amended financial statements.

1.13 Ind AS are mandatory from 1st April, 2016 (for 2016-17) for entities having net worth of ₹ 500 crore or more. Also the companies who are part of the group to which Ind AS is mandatory have to implement Ind AS in preparation of their financial statements. Accordingly, though net worth of ATL on 31st March,2016 was only ₹ 445 crore still it had to follow Ind AS in preparation of their financial statements.

On transition date i.e. 1st April, 2015, the company must had remeasured its assets as per Ind AS. At that time, Ind AS 20 did not give an option to deduct the amount of grant from the cost of the asset (but under AS 12, one can deduct the grant from the cost of the asset).

Ind AS 101 provides certain mandatory exceptions and voluntary exemptions from retrospective application of some aspects/requirements of Ind AS. However, in the absence of any mandatory exception applicable in this case, the company would have recognised the asset-related government grants outstanding on the transition date as deferred income in accordance with the requirements of Ind AS 20 and restated the carrying amount of the machinery at the date of transition to Ind AS.

Accordingly, on 1st April, 2015, the asset would be remeasured in the books, for the purpose of Ind AS compliance, at ₹ 17.78 (ie {20- 20/9}) and deferred grant income would be ₹1.78 (2/9 x 8) that is recognised in profit or loss on a systematic basis over the useful life of the asset. On 1st April, 2018, the value of deferred grant income would be ₹ 1.11 (2/9 x 5).

As per para 32 of Ind AS 20, repayment of a grant related to income shall be applied first against any unamortised deferred credit recognised in respect of the grant. To the extent that the repayment exceeds any such deferred credit, or when no deferred credit exists, the repayment shall be recognised immediately in profit or loss.

Accordingly, the entry for refund of government grant will be		₹	₹
Deferred grant income	Dr.	1.11 crore	
Profit and Loss A/c	Dr.	0.9 crore	
To Bank			2 crore

A government grant that becomes repayable shall be accounted for as a change in accounting estimate as per Ind AS 8, 'Accounting Policies, Changes in Accounting Estimates and Errors'.

1.14 Compliance of conditions of Corporate Governance in case of Listed Company: As per Listing Obligation and Disclosure Requirements Regulations 2015, depending upon the facts and circumstances, some situations may require an adverse or qualified statement or a disclosure without necessarily making it a subject matter of qualification in the Auditors' Certificate, in respect of compliance of requirements of corporate governance for example:

(i) The Audit Committee shall meet at least four times in a year and not more than one hundred and twenty days shall lapse between two meetings. The number of days between the meetings held on 1.9.2018 and 3.01.2019 is more than 120 days. Hence it is a non-compliance and would require qualification in certificate of corporate governance

(ii) Since the Chairman is the non-executive director, there should be 1/3rd of directors (rounded to next integer) to be independent. In this case, 4 directors need to be independent. Due to resignation by one of independent director, only 3 directors remain independent, this vacancy will again require qualification in certificate on corporate governance. As any vacancy during shortfall of independent directorship should be filled within next 3 months or before the start of next meeting, whichever is later. In the instant case, since the independent director was appointed after lapse of 3 months (i.e. on 1.9.2018) and after next meeting 1/6/2018, there is default which would require qualification in certificate on corporate governance.

(iii) The Audit Committee shall mandatorily review the Internal audit reports relating to internal control weaknesses as per Part C (B) of Schedule II and the auditor should ascertain from the minutes book of the Audit Committee and other sources like agenda papers, etc. whether the Audit Committee has reviewed the above-mentioned information. In the given situation, the agenda of Audit Committee did not deliberate or take note of serious irregularity mention in Quarter 3 Internal Audit Report which is again not in compliance of conditions of Corporate Governance and warrant audit qualification in certificate on corporate governance.

1.15 First of all, it has to be determined that whether the lease is a finance or operating lease. A finance lease is a lease that transfers substantially all the risks and rewards incidental to ownership of an asset. Title may or may not eventually be transferred. Paras 10 and 11 of Ind AS 17 discuss certain situations to determine a lease as finance lease namely -

(a) the lease transfers ownership of the asset to the lessee by the end of the lease term;

(b) the lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised;

(c) the lease term is for the major part of the economic life of the asset even if title is not transferred;

(d) at the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset; and

(e) the leased assets are of such a specialised nature that only the lessee can use them without major modifications.

To evaluate the above criteria, lets calculate the present value of minimum lease payment:

(i) Calculation of Annual Lease Payment

	₹
Cost of the equipment	10,00,000
Less: PV of unguaranteed residual value after 3rd year @ 10% (₹ 1,00,000 x 0.7513)	(75,130)
Fair value to be recovered from 3 years Annual Lease Payment	9,24,870
Annuity for 3 years @ 10%	2.4868
Annual Lease Payment (₹ 9,24,870 / 2.4868)	3,71,912

Present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset.

Further, the useful life of the asset is 5 years and the lease term is 3 years which implies that the lease term is for the major part of the economic life of the asset.

Hence the lease can be termed as finance lease.

Calculation of unearned finance income:

Unearned finance income = Gross investment in the lease – Net investment in the lease.

Where,

Gross investment = Minimum lease payments receivable by the lessor under a finance lease + Unguaranteed residual value accruing to the lessor (i.e. the gross investment in the lease discounted at the interest rate implicit in the lease)

Unearned finance income = ₹ [(3,71,912 x 3) + 1,00,000] – ₹ 10,00,000

= ₹12,15,736 – ₹ 10,00,000

= ₹ 2,15,736

1.16 The non-resident entity or the foreign company will be liable to tax in India only if the IT enabled BPO unit in India constitutes its Permanent Establishment.

In the present case, since Joe Weider Incorporation has an IT enabled Business Process Outsourcing unit in India (BPO) which provides certain outsourcing services to ATL, being a resident Indian entity, such BPO would be considered as Permanent Establishment of Joe Weider Incorporation, as it carries on business in India through the BPO Unit.

In such a case, the profits of Joe Weider Incorporation, attributable to the business activities carried out in India by the Permanent Establishment would become taxable in India.

Profits are to be attributed to the Permanent Establishment as if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a Permanent Establishment.

In determining the profits of a Permanent Establishment, there shall be allowed as deduction, expenses which are incurred for the purposes of the Permanent Establishment including executive and general administrative expenses so incurred, whether in the State in which the Permanent Establishment is situated or elsewhere.

1.17 Provision of Depreciation : Section 123(1) of the Companies Act, 2013 provides that dividend cannot be declared or paid by a company for any financial year except out of profits of the company for that year arrived at after providing for depreciation in accordance with the provisions of Section 123(2), or out of the profits or the company for any previous financial year or years arrived at after providing for depreciation in the manner aforementioned and remaining undistributed, or out of both. Further, it is the duty of auditor to check whether the depreciation was provided according to provision of AS 10 / IND AS 16/Schedule II to the Act.

In the instant case, the Company has track record of maintaining consistent dividend payment over a minimum of 14%. In the financial year 2017-18, the Board in order to conserve the funds for future operations decided not to declare dividend for FY 2017-18 and as a consequence, it was not possible for the Company to maintain the payment of consistent dividend. In addition to this management has also taken decision to charge 75% of the depreciation in the statement of Profit and Loss whereas 25% of the depreciation amount kept in a separate account code in the Balance Sheet – 'Debit Balances Adjustable against Revenue Account' for the financial year 2018-19.

Contention of management that it would be in fair practice of accounting where the depreciation of asset is charged before the expiry of the life of assets and the amount parked in asset code would unfailingly be adjusted to revenue before the close of next financial year is not tenable.

The practice of the company in not charging the depreciation and accumulating 25% of it in a debit balance for being written of in the next year is not an acceptable accounting treatment. If dividend is declared in such situation, it would mean payment out of capital.

Therefore, the auditor of the company should ensure the compliance of provisions of section 123 and Schedule II. In case the management does not comply with the provisions and does not charge the 100% depreciation the auditor of the company shall suggest the management for the same and if management refuses, the auditor should qualify his report accordingly.

CASE STUDY -2 :

Background:

You are an extrovert Chartered Accountant possessing excellent inter-personal and communication skills, hands-on rich industrial experience of nearly 25 years in all areas Corporate Finance, Direct Taxation, Legal, Cost and Management Accounting and Corporate Secretarial functions of large, listed, profit making companies and have carved a niche in the professional arena for your knowledge and presentation skills.

Recently, you have become a professional director of X Ltd., (hereinafter referred to as "the Company") a pharmaceutical company, listed with BSE and NSE. Besides being a director on the Board, the founder Chairman of the Company have specially assigned you to oversee the corporate accounting and finance functions of the Company and advise for raising short term and long term working capital from Banks, Financial Institutions, equity from private placement, rights issue, analyze capital budgeting, variance analysis etc.

You were more than happy to take over the charge as you believed in yourself and based on a successful track record of achievements in the past, you viewed this assignment as another challenge to deal with and come out successfully and also do value addition to the Company.

Upon taking over the mantle, you devoted considerable time in going through the corporate presentations, strategic strengths of the Company, risk factors (internal and external), industry analysis, manufacturing processes, peer analysis, stock performances, government approvals and licenses, litigations (by and against the Company), income tax assessments and appeals in force, audited financial results of the Company for the past few years, organization structure, *management culture, corporate governance and the Board processes, etc., After spending considerable time on making an in-depth analysis, you observed and noted the following:*

(a) The Company's core strength lies in developing and manufacturing differentiated pharmaceutical products in-house, which it commercializes through its marketing infrastructure spread across geographies and relationships with multi-national pharma companies. Benchmarked to international standards, X Ltd.' s facilities are approved by international regulatory agencies such as US FDA, UK MHRA, Japan's MHLW, TGA Australia, WHO, and the MCC South Africa;

(b) Until before the past three financial years, the Company was performing well and the trading update statements were met with much approval by market analysts and as a consequence the Company's share price rose accordingly;

(c) Unfortunately, in the recent years, the Company suffered from cash flow issues caused by rapid growth, undercapitalization, and lack of financial management expertise and control processes;

(d) The Company's accumulated losses coupled with liquidity issues is gradually reducing the reserves and surpluses and could be a threat to the Company's future viability if not corrected suitably;

(e) The Company also needed financial restructuring and a solid, experienced financial advisor if the Company was to succeed;

(f) The Company needed to raise considerable equity capital to fund the continuation of their product development and their sales and marketing efforts;

(g) Previously, the Company had raised limited capital from local Angel investors, but now needed to attract sophisticated institutional investors.

Management:

You observe that the top management consisted of mostly aged and experienced personalities but for their knowledge on information technology and computer skills.

Mr. 'A', the Director (Operations) was recruited by the Managing Director (MD) two years ago and by all accounts is a big favorite with the analysts. The two of them had previously worked together at a smaller listed Company. However, Mr. 'A' appears to be the MD's man and the board is actually run by Mr. 'A'. The roles of Mr. A and MD, although held by separate individuals, are effectively held by the same individual.

The terms of appointment of Mr. 'A' provided that in the absence of adequacy of profits, or if the Company had no profits in a particular financial year, he will be paid remuneration as per Schedule V of the Companies Act, 2013. The Company suffered heavy losses during the financial year ended 31st March, 2019. The Company was not able to pay any remuneration, but Mr. A was paid ₹ 50 lakhs as was paid to other directors. The effective capital of the Company is ₹ 250 crores.

You have heard rumours that the CFO of the Company "resigned" because he was one of the few individuals to have challenged the Director (Operations). However, the official line is that he was a trouble maker and did not fit into the balance of the board and other management executives.

After the departure of the CFO, you were informed that the Company's accounting function s were not up to the required level as many accounting entries made were either inaccurate nor did they comply with mandatory Ind AS. You are understandably concerned that the accounting records would not pass the rigorous due diligence if conducted by any new institutional investors.

Furthermore, you were informed that there is a lack of debate at board meetings, which in your eyes appear to be more of a rubber-stamping exercise rather than a forum to have some serious strategic discussions. You also have concerns that the board papers are only sent out 2 days before the meeting, which in your opinion is not sufficient time to allow any member of the Board and the Audit Committee to thoroughly review them.

At the next meeting of the board you are very surprised to find out that the Company is in discussions to purchase a major competitor based in the US. In the board papers, this was not even briefly mentioned and it only said as though X Ltd. was merely looking at a number of possible acquisition targets based primarily in the Asia region. You are surprised - both by the location of the target company - but even more by what it is likely to cost. The Director (Operations) proceeds to give a powerful presentation on the pros and cons of the proposed deal. His talk consists of an overview of the target company, the likely cost of acquisition and strongly highlights the benefits of "doing the deal".

The risks attached to the deal were significantly downplayed. The price mentioned was in the region of Singapore Dollars (SGD) 250 million, which is a very significant sum for X Ltd. and which confirms your earlier fears. As X Ltd. has not performed very well in recent years, in order to finance this type of deal, considerable debt will be required and the Company's level of gearing will be significantly increased.

Subsequently, you took up the matter with the Audit Committee, the MD, Director (Operations) and the Independent Directors and sought their immediate intervention for a correction and consolidation. After a brief discussions on your inputs, the MD of the Company had assigned you with the following challenges :

The Challenge:

(a) Oversee the accounting functions, with special reference to accounting treatment in line with generally accepted accounting principles and compliance of all applicable mandatory accounting standards;

(b) Assist the MD by making sure that the existing financial statements are reliable and understandable and stands the test of due diligence in connection with raising funds;

(c) Clean up the company's finances and help find bridge capital;

(d) Establish new banking relationships and secure a loan;

(e) Devise a plan to help the Company set goals for predicted future growth and cash flow requirements;

(f) Ensure compliances with all the applicable provisions of the Companies Act, 2013, SEBI guidelines / SEBI (LODR) Regulations, 2015 and stock exchange formalities.

Keeping in view of the above responsibilities, you commence your work initially with a detailed perusal of the various accounting entries made in the books of accounts of the Company commencing from 1st April, 2018 onwards. Based on the above and further information provided in Part-A and Part-B, answer the questions 2.1 to 2.15.

During the course of your interaction with the Company Secretary of the Company you have come across / been appraised of the following situations :

You are requested to read carefully and provide the correct option to the following questions :

2.1. Mr. Q, a Director of the Company proceeding on a long foreign tour, appointed Mr. Y as an alternate director to act for him during his absence. The articles of the Company provide for appointment of alternate directors. Mr. Q claims that he has a right to appoint an alternate director. The contention of Mr. Q is :

(A) Correct. As the Articles of the Company provide for appointment of an alternate Director;

(B) Incorrect. As. the authority to appoint alternate director has been vested in the board of directors only and that too subject to empowerment by the Articles;

(C) Incorrect. As the authority to appoint alternate director has been vested in the board of directors only and with approval of shareholders by passing a special resolution;

(D) Incorrect. As the authority to appoint alternate director has been vested only with the approval of shareholders by passing a special resolution.

2.2 Annual general meeting of the Company has been scheduled in compliance the requirements of the Companies Act, 2013. In this connection, there are some directors who are rotational and out of which some have been appointed long back, some have been appointed on the same day. Which of the directors shall be retiring by rotation at the ensuing Annual General Meeting:

(A) One third of those directors who have been longest in the office who constitute one half of the total number of directors and who are liable for rotation at every AGM;

(B) One half of those directors who constitute two thirds of the total number of directors and who are liable for rotation at every AGM;

(C) One third of those directors who constitute two thirds of the total number of directors and who are liable for rotation at every AGM;

(D) One half of those directors who have been longest in the office who constitute one half of the total number of directors and who are liable for rotation at every AGM.

2.3 Mr. Kishore is a Director of the Company and also of PQ Ltd. PQ Ltd. did not file financial statements for the years ended 31st March, 2017 and 2018 and did not pay interest on loans taken from a public financial institution from 1st April, 2018 onwards. But it has promptly repaid matured deposits taken from public on due dates. In the light of relevant provisions of the Companies Act, 2013, Mr. Kishore is :

(A) Disqualified to continue as a Director in the Company;

(B) Disqualified to continue as a Director in PQ Ltd;

(C) Disqualified to continue as a Director in the Company and PQ Ltd;

(D) Not Disqualified and hence he can continue as a Director of the Company and PQ Ltd.

2.4 The Company had incurred loss in business up to the first quarter of financial year 2018-19. The Company has declared dividend at the rate of 12%, 15% and 18% respectively in the immediate preceding three years.

In-spite of the loss, the Board of Directors of the company have decided to declare interim dividend @ 15% for the current financial year. With reference to the provisions of the Companies Act, 2013 on declaration of interim dividend, the decision of the Company is:

(A) Correct, subject to approval of shareholders;

(B) Incorrect, as the dividend-can be only average of last 3 years;

(C) Correct, subject to approval of Central Government;

(D) Incorrect, as the dividend can be only lowest of last 3 years.

2.5 On your interaction with the finance department, you have come across / been appraised of the following situations.

The Company was working on different contracts which are likely to be completed within 3 years period. It recognizes revenue from these contracts on percentage of completion method for financial statements during 2015-2016, 2016-2017 and 2017-2018 for ₹11,00,000, ₹16,00,000 and ₹21,00,000 respectively. However, for Income-tax purpose, it has adopted the completed contract method under which it has recognized revenue of ₹ 7,00,000, ₹18,00,000 and ₹23,00,000 for the years 2015-2016,2016-2017 and 2017-2018 respectively. Income-tax rate is 35%.

Accordingly, the amount of deferred tax asset/liability for the years 2015-2016, 2016-2017 and 2017-2018 as per the provisions of Ind AS 12 would be:

(A) ₹1,40,000; ₹70,000; ₹Nil;

(B) ₹ Nil; ₹ 70,000; ₹ 1,40,000;

(C) ₹ 70,000; ₹ 1,40,000; ₹ Nil;

(D) ₹ 1,40,000; ₹ Nil; ₹ 70,000.

2.6 The Company had borrowed a sum of US $ 10,00,000 at the beginning of financial year 2018-19 for one of its residential project at 4%. The interest is payable at the end of the financial year. At the time of availment, exchange rate was ₹ 56 per US $ and the rate as on 31st March, 2019 was ₹ 62 per US $. If the Company borrowed the loan in India in Indian Rupee equivalent, the pricing of loan would have been 10.50%. In such circumstances, the borrowing cost and exchange difference for the year ending 31st March, 2019 as per applicable Accounting Standards would be:

(A) Borrowing Costs - ₹ 60.00 lakhs; Exchange Difference - ₹ 30 lakhs;

(B) Borrowing Costs - ₹ 58.00 lakhs; Exchange Difference - ₹ 27 lakhs;

(C) Borrowing Costs - ₹ 58.80 lakhs; Exchange Difference - ₹ 26 lakhs;

(D) Borrowing Costs - ₹ 59.70 lakhs; Exchange Difference - ₹ 24 lakhs.

2.7 While preparing the draft final accounts for the year ended 31st March, 2019, the Company made provision for bad debts @ 5% of its total debtors. In the last week of February, 2019 a debtor for ₹ 20 lakhs had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. In April, 2019 the debtor became bankrupt. The Company provided for the full loss of ₹ 20 lakhs minus 5% provision already made arising out of insolvency of the debtor in the final accounts for the year ended 31st March, 2019. The correct accounting treatment is :

(A) Provide as per the company's judgement;

(B) Provide for entire ₹ 20 lakh;

(C) Only 5% of ₹ 20 Lakh is to be provided;

(D) None of the above

2.8 Goods were sold amounting to ₹ 50 lakh to an associate company during the 1st quarter ended on 30th June, 2018. After that, related party relationship ceased to exist. However, goods were supplied as was supplied to any other ordinary customer. What is the disclosure as per the applicable accounting standards ?

(A) Disclosure is for transactions for the whole year;

(B) Disclosure is only for the transactions upto the first quarter ended 30th June, 2018;

(C) Does not come within the ambit of disclosure;

(D) Only the transactions for the remaining three quarters need to be disclosed.

2.9 The Company purchased machinery on 1st April, 2014 for ₹ 35 lakh. Written down value of the machinery as on 31st March, 2019 is ₹ 18.27 lakh. The recoverable amount of the *machinery is ₹ 12.45 lakh. Under the circumstances, the impairment loss as per the applicable accounting standard would be :*

(A) ₹ 16.73 Lakhs;

(B) ₹ 22.55 Lakhs;

(C) ₹ 5.82 Lakhs;

(D) ₹ 4.28 Lakhs.

2.10 The Company purchased goods at the cost of ₹ 20 lakhs in October, 2018. Till the end of the financial year, 75% of the stocks were sold. The Company wants to disclose closing stock at ₹ 5 lakhs. The expected sale value is ₹ 5.5 lakhs and a commission at 10% on sale is payable to the agent. The correct value of closing stock would be :

(A) ₹ 4.95 Lakhs;

(B) ₹ 4.85 Lakhs;

(C) ₹ 4.75 Lakhs;

(D) ₹ 4.50 Lakhs. ***(2 x 10 = 20 Marks)***

PART-B

2.11 The Company had earlier purchased a small bottle manufacturing plant meant for storing medicines for ₹ 24 lakhs on 1st April, 2016. The useful life of the plant was 8 years. On 30th September, 2018, the Company temporarily stopped using the manufacturing plant because the demand for such bottles by the Company had declined. However, the plant was maintained in a workable condition and it would be used in future when demand picks up. The accountant of the Company decided to treat the plant as held for sale until the demand picks up and accordingly measures the plant at lower of carrying amount and fair value less cost to sell. The accountant has also stopped charging depreciation for rest of the period considering the plant as held for sale. The fair value less cost to sell on 30th September, 2018 and 31st March, 2019 was ₹ 13.5 lakh and ₹ 12 lakh respectively.

The Accountant has made the following workings :

Carrying amount on initial classification as held for sale.

	(₹)	(₹)
Purchase price of Plant	*24,00,000*	
Less: Accumulated Depreciation		
[(₹ 24,00,000/8) x 2.5 years]	*(7,50,000)*	*16,50,000*
Fair value less cost to sell as on 31st March, 2018		*12,00,000*
The value lower of the above two		*12,00,000*

Balance Sheet extracts as on 31st March, 2019

Particulars	***(₹)***
Assets	
Current Assets	
Assets classified as held for sale	*12,00,000*

Analyze whether the above accounting treatment is in compliance with the applicable Ind AS. If not, advise the correct treatment showing necessary workings. ***(8 Marks)***

2.12 The Company on 1st April, 2015 had issued 50,000, 7% convertible debentures of face value of ₹ 100 per debenture at par. The debentures were redeemable at a premium of 10% on 31st March, 2020 or these may be converted into ordinary shares at the option of the holder. The interest rate for equivalent debentures without conversion rights would be 10%.

The date of transition to Ind AS is 1st April, 2018.

Suggest how the Company should account for this compound financial instrument on the date of transition. Also discuss Ind AS on 'Financial Instrument' presentation in the above context. The present value of Re 1 receivable at the end of each year based on discount rates of 7% and 10% can be taken as :

End of Year	*1*	*2*	*3*	*4*	*5*
7%	*0.94*	*0.87*	*0.82*	*0.76*	*0.71*
10%	*0.91*	*0.83*	*0.75*	*0.68*	*0.62*

(6 Marks)

2.13 The Company had two trademarks - 'X' and 'Y'. One month before, the Company had come to know through its marketing managers that these two trademarks have allegedly been infringed by other competitors engaged in the same field. After enquiry and investigation, the legal department of the company informed that it had a weak case on trade mark 'X' and strong case in regard to trade mark 'Y'. The Company incurred additional legal expenses to stop infringement on both trademarks. Both trademarks have a remaining legal life of 10 years. The Accountant of the Company was not knowing as to how to account these legal costs incurred relating to two trademarks.

In respect of the two trademarks, what is the correct accounting treatment in respect of the additional legal expenses incurred ? ***(4 Marks)***

2.14. You observe that the Company has been making estimates in the carrying amount of an asset or a liability. On perusal of the estimates made by the Company you feel that the estimates made by the Company need a revision based on certain new information as a result of which a change in the accounting estimate is required.

Explain revision in estimates including recognition in financial statements as enshrined in Ind AS 8. ***(6 Marks)***

2.15. *Based on the information provided in first para on page 18 (of printed copy of Question Paper. "The terms of appointment of Mr. 'A' ------------- effective capital of the Company is ₹ 250 crores.") and referring to the provisions of the Companies Act, 2013 as contained in Schedule V, examine the validity of payment of remuneration to Mr. A – Director (Operations).* ***(6 Marks)***

ANSWER TO CASE STUDY 2

PART – A

2.1 (B)

2.2 (C)

2.3 (D)

2.4 (A)

2.5 (A)

2.6 (C)

2.7 (B)

2.8 (B)

2.9 (C)

2.10 (A)

PART – B

2.11 As per Ind AS 105 'Non-current Assets Held for Sale and Discontinued Operations', an entity shall classify a non-current asset as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use.

For asset to be classified as held for sale, it must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets and its sale must be highly probable. In such a situation, an asset cannot be classified as a non-current asset held for sale, if the entity intends to sell it in a distant future.

For the sale to be highly probable, the appropriate level of management must be committed to a plan to sell the asset, and an active programme to locate a buyer and complete the plan must have been initiated. Further, the asset must be actively marketed for sale at a price that is reasonable in relation to its current fair value. In addition, the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification and actions required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

Further Ind AS 105 also states that an entity shall not classify as held for sale a non-current asset that is to be abandoned. This is because its carrying amount will be recovered principally through continuing use.

An entity shall not account for a non-current asset that has been temporarily taken out of use as if it had been abandoned.

In addition to Ind AS 105, Ind AS 16 states that depreciation does not cease when the asset becomes idle or is retired from active use unless the asset is fully depreciated.

The Accountant of the company has treated the plant as held for sale and measured it at the fair value less cost to sell. Also, the depreciation has not been charged thereon since the date of classification as held for sale which is not correct and not in accordance with Ind AS 105 and Ind AS 16.

Accordingly, the manufacturing plant should neither be treated as abandoned asset nor as held for sale because its carrying amount will be principally recovered through continuous use. The company shall not stop charging depreciation or treat the plant as held for sale because its carrying amount will be recovered principally through continuing use to the end of their economic life.

The working of the same for presenting in the balance sheet will be as follows:

Calculation of carrying amount as on 31st March, 2019	₹
Purchase Price of Plant	24,00,000
Less: Accumulated depreciation (24,00,000/ 8 years) x 3 years	(9,00,000)
Carrying amount before impairment	15,00,000
Less: Impairment loss (Refer Working Note)	(3,00,000)
Revised carrying amount after impairment	12,00,000

Balance Sheet extracts as on 31st March 2019

Assets	₹
Non-Current Assets	
Property, Plant and Equipment	12,00,000

Working Note:

Fair value less cost to sell of the Plant = ₹ 12,00,000

Value in Use (not given) or = Nil (since plant has temporarily not been used for manufacturing due to decline in demand)

Recoverable amount = higher of above i.e. ₹ 12,00,000

Impairment loss = Carrying amount – Recoverable amount

Impairment loss = ₹ 15,00,000 - ₹12,00,000= ₹ 3,00,000.

2.12 Since the liability is outstanding on the date of Ind AS transition, the company is required to split the convertible debentures into debt and equity portion on the date of transition. Accordingly, first the liability component will be measured discounting the contractually determined stream of future cash flows (interest and principal) to present value by using the discount rate of 10% p.a. (being the market interest rate for similar debentures with no conversion option).

Calculation of Equity & Liability component on initial recognition

	(₹)
Present Interest payments for 5 years on debentures by applying annuity factor [(50,000 x 7% x 100) x 3.79]	13,26,500
PV of principal repayment (including premium) (50,000x110 x 0.62)	34,10,000
Total liability component	47,36,500
Total equity component (Balancing figure)	2,63,500
Total proceeds from issue of Debentures	50,00,000

Thus, on the date of transition ie 1st April, 2018, the amount of ₹ 50,00,000 being the amount of debentures will split as under:

Debt	₹ 47,36,500
Equity	₹ 2,63,500

2.13 As per para 20 of Ind AS 38 'Intangible Assets', most subsequent expenditures are likely to maintain the expected future economic benefits embodied in an existing intangible asset rather than meet the definition of an intangible asset and the recognition criteria. Hence, such subsequent expenditure on an intangible asset after its purchase or its completion should be recognized as an expense.

The legal costs incurred for both the trademarks do not enable them to generate future economic benefits in excess of its originally assessed standard of performance. They only ensure to maintain them if the case is decided in favour of the company. Therefore, such legal costs must be recognised as an expense.

2.14 As per para 34 to 40 of Ind AS 8, 'Accounting Policies, Changes in Accounting Estimates and Errors', an estimate may need revision if changes occur in the circumstances on which the estimate was based or as a result of new information or more experience. By its nature, the revision of an estimate does not relate to prior periods and is not the correction of an error.

When it is difficult to distinguish a change in an accounting policy from a change in an accounting estimate, the change is treated as a change in an accounting estimate.

Recognition in the financial statements

The effect of a change in an accounting estimate, shall be recognised prospectively by including it in profit or loss in:

(a) the period of the change, if the change affects that period only; or

(b) the period of the change and future periods, if the change affects both.

To the extent that a change in an accounting estimate gives rise to changes in assets and liabilities, or relates to an item of equity, it shall be recognised by adjusting the carrying amount of the related asset, liability or equity item in the period of the change.

The effect of the change relating to the current period is recognised as income or expense in the current period. The effect, if any, on future periods is recognised as income or expense in those future periods.

Disclosure

An entity shall disclose the nature and amount of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in future periods, except for the disclosure of the effect on future periods when it is impracticable to estimate that effect. If the amount of the effect in future periods is not disclosed because estimating it is impracticable, an entity shall disclose that fact.

2.15 As per Section II of PART II to Schedule V, where in any financial year during the currency of tenure of a managerial person, a company has no profits or its profits are inadequate, it may, pay remuneration to the managerial person not exceeding, ₹ 120 lakhs plus 0.01% of the effective capital in excess of ₹ 250 crores, if the effective capital of the company is ₹ 250 crores and above.

In the given situation, the company has effective capital of ₹ 250 crores. The company has suffered heavy losses and paid Mr. A (Director- Operations) remuneration of ₹ 50 lakhs.

In the light of the provisions of the Act and facts of the case study, the remuneration payable to Mr. A is in consonance with the provisions of the Companies Act, 2013.

[Note: The question has asked about payment of remuneration to 'Mr. X – Director (Operations)'. This seems to be clerical error. Thus, Mr. X should be read as Mr. A.]

CASE STUDY -3:

Background :

You are a respected Chartered Accountant recognized for your sharp intellectual acumen on Direct Taxation, Capital Markets, FEMA, Corporate and Allied Laws with special reference to compliance related matters. Your expertise on the technical aspects of various laws in force in India had given you a deep recognition in such a way that you are approached for advice and solutions not only by domestic companies spread across India but also by foreign companies who want to set up businesses in India, who are more often than not wary about complex *regulatory set up in India. You are ably supported by your other qualified six partners and a large team of assistants in all your advisory matters.*

The Company:

You have been recently approached by M/s. MG Software and Exports Limited, a listed entity, incorporated on May 24, 2001. The Company offers various services, such as consulting services, business services, technology services and outsourcing services. The Company's consulting services include enterprise applications, digital transformation, in sights and analytics, and change and learning. Its business services include Data Analytics, Digital and Oracle. Its technology services include application management; cloud, infrastructure and security; engineering services; enterprise mobility; Internet of Things (IoT) and testing. Its outsourcing services include application outsourcing, business process outsourcing, customer service, finance and accounting, human resources, and sourcing and procurement.

The Company's segments are Financial Services and Insurance (FSI), Manufacturing and Hi-tech (MFC & Hi-TECH), Energy & utilities, Communication and Services (ECS), Retail, Consumer packaged goods and Logistics (RCL), and Life Sciences and Healthcare (LSH). The Company operates in India, North America, Europe and Rest of the World.

Founder Chairman and New Managing Director:

The Company's founder Chairman and Managing Director, Mr. Madhav Ganapathy (MG) has retired from his position and has inducted in his place his young son Mr. Daivignay, aged 24 years, a research scholar from Harvard University as the new Managing Director (MD) after due approval of the Board as well as the shareholders at the annual general meeting of the company held on 29th September, 2018.

Attributes of Mr. Daivignay

Mr. Daivignay, being a born extrovert, immediately after taking his mantle as the new MD, decided first to get fully acquainted with the regulatory set up of India as he believed that though India is gearing up for simplifying the laws and aiming at ease of doing business, the penalties for non-compliances have been made more severe and therefore an utmost care is warranted in ensuring due compliances of various laws and regulations, He also wanted to understand the regulatory environment including the litigation settlement process especially the time taken for disposal of cases by the judiciary.

He further believed that as the complexities of businesses increase, the amount of time spent by professionals in cracking up the law codes increases. However, tax and regulatory systems of even the most developed countries cannot keep pace with the developments across each industry as businesses emerge day-by-day. These also bring out the requirements for new compliances and the challenges of meeting them every single day-more detailed Income Tax Return forms including disclosures on tax residency certificates and details of foreign assets, *and higher penalties for non disclosures require businesses to gear up for efficient tax compliance.*

With this back drop, he consulted his father to suggest a professional who could run through in a simplified and sharp manner the current state of affairs of the company in terms of business, profits and growth strategy, an insight into the laws and regulations that are applicable to the company, licenses and regulatory permissions, compliance standards which may potentially have an impact on the business of the company.

MG immediately suggested your name as the right person to answer all of Mr. Daivignay's apprehensions. Subsequently, you were approached for a meeting at 11.00 AM at the Board Room situated on the ninth floor of the Corporate Office on 24th May, 2019. You were provided in advance a week before the meeting, the audited financials of the Company for the last five years, corporate presentations in a CD, copies of the income tax assessment orders, appeals preferred by the Company before CIT(Appeals) and ITAT, summary of financial highlights with ratio analysis etc., On the appointed day, you were present along with three of you partners.

The Meeting:

On 24th May, 2019 MG, Mr. Daivignay and a team of professionals of the company were excited and waiting to greet you and your team. You and your partners turned up for the meeting exactly at 11.00 AM. The Board Room was fully equipped with all high end audio and video infra-structure with a seating capacity of 20 members. After initial pleasantries including appreciation for your punctuality, the meeting commenced. MG expressed his first intention to you to make a presentation on an overview of the Income Tax Act, 1961 and with special reference to those provisions affecting the Company and followed by the difference between tax planning, tax management and tax evasion.

Aspects under the Income-tax Act, 1961:

Accordingly, you made a presentation on the following :

An overview of Income Tax Act, 1961, concept of previous year, assessment year, tax rate structure, exemptions, deductions, clubbing provisions set-off and carry forward of losses, rebates and reliefs, computation of total income and tax liability, TDS/TCS, assessment procedures refund and recovery and levy of penalties.

You also made presentations on those provisions that were directly applicable to the Company and summarized the differences between tax planning and tax evasion and indicated that they look alike but have greater repercussions if not handled properly given the complexity of the tax laws. You also touched upon tax management in a nutshell. Thereafter, Mr. Daivignay and his Managers had brain storming sessions on various matters concerning Income tax Act, 1961 that had direct application to the company whereupon you and your learned team members clarified all their doubts to their best satisfaction.

Summary of Financial information of the Company's subsidiary :

The management team also placed for your perusal certain financial information in respect of one of the Company's subsidiaries as at 31st Match, 2019 as under:

(1) Net Profit as per Statement of Profit and Loss ₹ 36,50,000

(2) Items debited/credited to statement of profit and loss :

Bad debt written off in previous year 2017-18 ₹ 2,50,000 of which ₹ 1,80,000 was recovered in July, 2018;

CSR expenditure by way of putting traffic signal outside the factory ₹ 2 lakhs;

Donation to a registered political party ₹ 70,000. Of this, paid by cash ₹ 30,000 and by cheque ₹ 40,000;

Amount received as 30% share in an AOP ₹ 1,20,000. The AOP is engaged in the business of plastic mould manufacture;

Long term capital gain on sale of unlisted shares (without indexation) ₹ 50,000. (Note: With indexation, the long-term capital gain is ₹ 30,000);

Dividend from domestic companies received during the year ₹ 11,00,000;

₹ 20 lakhs was paid to a founder director by way of goodwill, who resigned from the company on 30th April 2018. No tax was deducted at source on the said payment;

Depreciation debited ₹ 13,50,000;

Deferred tax liability debited to profit and loss account ₹ 3 lakhs;

Royalty ₹ 10 lakh received in respect of patent developed and registered in India by the assessee.

Clarifications for Foreign Exchange Transactions:

After a short break, the meeting commenced further and at this point of time, the focus was on the Foreign Exchange Management Act, 1999. Mr. Daivignay initially wanted to know from you the need of such an Act. To this question, you answered that due to significant developments in the economic scenario such as substantial increase in our foreign exchange reserves, growth in foreign trade, rationalization of tariffs, current account convertibility, liberalization of investments abroad, increased external commercial borrowings by Indian corporates and participation of foreign Institutional investors in our stock markets necessitated the need for an enforcement of the legislation to regulate foreign trade and investments. In order to facilitate world trade and easy and regulated inflow and outflow of foreign exchange, the Foreign Exchange Management Act, 1999 (FEMA) was enacted.

You further explained that whilst the provisions of FEMA have been simplified substantially from the 'Control based approach' to Management based approach" a thorough analysis of various foreign currency transactions would be absolutely essential for ensuring zero-non compliance.

Thereafter, Mr. Daivignay enquired with you the FEMA regulations as applicable to their Indian operations and sought your clarifications on the following :

(1) Meaning of Capital and Current Account Transactions;

(2) Transactions for which drawal of foreign exchange is prohibited;

(3) Transactions, which require prior approval of the Government of India for drawal of foreign exchange;

(4) Transactions, which require RBI's prior approval for drawal of foreign exchange;

(5) What are permissible and prohibited transactions?

You briefed with appropriate inputs with clarity to the above enquiries made by Mr. Daivignay.

Costing Implications:

Later, Mr. Abhinandanan, Manager (Finance) had certain apprehensions on Costing related matters and brought to your information the following details in respect of a new division of the company which produces and sells a single product.

(a) Presently, the division is having its quality control system in a small way at an annual external and internal failure costs of ₹ 4,40,000 and ₹ 8,50,000 respectively;

(b) The company is unable to supply quality products to the satisfaction of the customer;

(c) To retain the market share and face competition, the division wants to have an alternate quality control system;

(d) It is expected that the implementation of the system annually will lead to a preventive cost of ₹ 5,60,000 and an appraisal cost of ₹ 70,000;

(e) The external and internal failure costs will reduce by ₹ 1,00.000 and ₹ 4,10,000 respectively in the new system;

(f) All other activities and costs will remain unchanged.

Settlement Mechanism under Insolvency and Bankruptcy Code, 2016 :

Thereafter, Mr. Daivignay raised the legal remedies available in India for recovering amounts rightfully due to the Company, in case of default of the borrower with reference to the provisions of Insolvency and Bankruptcy Code, 2016 as he believed that it would come handy for enforcing timely actions by the defaulting customers, where required. He also wanted to understand how the settlement of dues would be prioritized as compared to various secured creditors at the time of insolvency.

Company Law Implications:

Mr. Daivignay, also wanted your briefings on:

- *Independent Directors and Women Director on the Board and their roles and responsibilities for compliances with laws and regulations;*
- *Compliance requirements relating to Related Party Transactions;*
- *The roles and functions of Audit Committee;*
- *Compliance audit vis-a-vis setting up of a compliance Committee;*
- *The need for legislation of the role of Whistle Blowers;*
- *Disclosure requirements under SEBI(LODR) Regulations, 2015.*

You amplified at a high level to the above issues and to the extent relevant to the current operations of the company. After hearing you, Mr. Daivignay was wondering whether the Company Secretary, Internal Auditor and the Statutory Auditor would give him comfort on the compliance requirements and the roles and responsibilities of the statutory auditors on this matter under the auditing standards prevailing in India as referred to under the Companies Act, 2013.

Expectations from You:

You are requested to answer to the following questions based on your understanding of the requirements of MG, Mr. Daivignay and his Company's team. You can make your relevant assumptions as may be required to explain your answer so as to provide a more meaningful understanding and a relevant feedback. Needless to emphasize, your responses would go a long way to enable the new and young MD, Mr. Daivignay in steering the Company with utmost care ensuring zero non-compliances and therefore, your best advice is expected.

Answer all the Questions :

3.1 Amendments by the Finance Act are made applicable from:

(A) First day of next financial year;

(B) First day of same financial year;

(C) Last day of same Accounting year;

(D) None of the above

3.2 The time limit for completion of assessment under section-143/144 of the Income-tax Act, 1961 shall from 1st April, 2019 onwards be :

(A) 21 months from the end of the relevant assessment year in which income was first assessable;

(B) 12 months from the end of the relevant assessment year which income was first assessable;

(C) 18 months from the end of the month in which the return was so furnished;

(D) 36 months from the end of the relevant assessment year which income was first assessable.

3.3 Which of the following transactions is not permissible as Capital Account Transaction under the FEMA, 1999 ?

(A) Investment by person resident in India in Foreign securities;

(B) Foreign Currency Loans raised in India and abroad by a person resident in India;

(C) Export, Import and holding of currency/currency notes;

(D) None of the above

3.4 A current account transaction as defined by FEMA, 1999 is a transaction other than a capital account transaction and without prejudice to the generality of the foregoing such transaction includes:

(A) Payments due in connection with foreign trade, other current business, services short term as well as long term banking and credit facilities in the ordinary course of business;

(B) Acquisition or transfer of immovable property in India, by a person outside India;

(C) Remittances for living expenses of parents, spouse and children residing abroad;

(D) All of the above

3.5 Under the provisions of the Insolvency and Bankruptcy Code as enshrined in Section 21 of the Code, analyze the correctness of the following statements :

(1) A financial creditor or the authorized representative of the financial creditor, if it happens to be a related party of the corporate debtor shall not have any right of representation, participation or voting in a meeting of the committee of creditors;

(2) A financial creditor regulated by a financial sector regulator, if it is a related party of the corporate debtor solely on account of conversion or substitution of debt into equity shares or instruments convertible into equity shares prior to the insolvency commencement date shall not have any right of representation, participation or voting in a meeting of the committee of directors;

(A) Statement 1 is correct whereas, statement 2 is incorrect;

(B) Statement 1 is incorrect whereas, statement 2 is correct;

(C) Both the statements are correct.

(D) Both the statements are incorrect.

3.6 Where a corporate debtor has committed a default, a corporate applicant thereof may file an application for initiating corporate insolvency resolution process with the Adjudicating Authority. Choose the correct circumstance whereby the Adjudicating Authority may allow the withdrawal of application admitted under Sections 7 or 9 or 10.

(A) On an application made by the applicant with the approval of 60% voting share of the Committee of Creditors;

(B) On an application made by the applicant with the approval of 75% voting share of the Committee of Creditors;

(C) On an application made by the applicant with the approval of 90% voting share of the Committee of Creditors;

(D) The Adjudicating Authority shall not allow the withdrawal of application after admission as the application can be withdrawn only before its admission.

3.7 As per Section-5(12) of the Insolvency and Bankruptcy Code, 2016, the term "Insolvency Commencement Date" means the date on which:

(A) A financial creditor, corporate applicant or operational creditor as the case may be makes an application to the Adjudicating Authority for initiating corporate insolvency resolution process;

(B) Interim Resolution Professional accepts the Adjudicating Authority Order for initiating corporate insolvency resolution process;

(C) Adjudicating Authority admits the order for initiating corporate insolvency process;

(D) Adjudicating Authority appoints Interim Resolution Professional for initiating corporate insolvency resolution process.

3.8 The Board of Directors of the Company had recommended dividend of 20% on paid up equity share capital for the financial year ended 31st March, 2018 at their meeting held on 10th of May, 2018 when the accounts for the financial year 2017-18 were approved. The Board of Directors when they met on 9th July, 2018 for the review of 1st quarter accounts, had decided to rescind their decision to recommend dividend. The Notice of AGM to be held on 29th September 2018 was sent on 14th August 2018 without any recommendation of dividend. At the AGM, the shareholders asked the Management how they can rescind the declaration of dividend once recommended. In this regard:

(A) It is not within the powers of the Board of Directors to rescind their decision to recommend dividend;

(B) It is within the powers of the Board of Directors to rescind their decision to recommend dividend;

(C) Members have powers to declare dividend in the AGM despite revocation of dividend by the Board of Directors;

(D) None of the above

3.9. The Company is considering the proposal for appointment of following persons as Independent Directors :

Mr. A, Promoter of C Ltd., Holding Company of ABC Ltd;

Mr. B, Relative of Promoter of D Ltd. Subsidiary of ABC Ltd;

Mr. C, Company Secretary of Associate Company;

Mr. D, Shareholder of the Company holding 1% voting power of the Company;

Mr. E, whose relative is indebted to the Director of the Company for an amount of ₹ 15 Lakhs.

Mr. F, whose relative is indebted to the Director of the holding Company for an amount of ₹ 25 Lakhs;

Mr. G, whose relative is indebted to the Associate Company for an amount of ₹ 20 Lakhs.

Which of the persons mentioned above are disqualified to be appointed as Independent Director?

(A) All except Mr. A, Mr. B and Mr. C;

(B) All except Mr. E, Mr. F and Mr. G;

(C) All except Mr. D, Mr. E and Mr. F and Mr. G;

(D) All except Mr. D, Mr. E and Mr. F

3.10. As per Section-123 of the Companies Act, 2013, no Company shall declare dividend unless:

(A) Carried over previous losses and depreciation not provided in previous year or years are set-off against accumulated profits of the Company;

(B) Carried over previous losses and depreciation not provided in previous year or years whichever is less, are set-off against profit of the Company for the current year;

(C) Carried over previous losses and depreciation not provided in previous year or years whichever is higher, are set-off against profit of the Company for the current year;

(D) All of the above ***(2 x 10 = 20 Marks)***

PART·B

Answer all Questions:

3.11 Are there any exceptions to the rule that the income of the previous year shall be assessed in the subsequent assessment year? If yes, state the exceptions. **(7 Marks)**

3.12 What is the difference between exemptions under section 10 and deductions provided under Chapter -VIA under the Income-tax Act, 1961? ***(3 Marks)***

3.13 In respect of certain financial information given by the management team in respect of the Company's subsidiary as at 31st March, 2019 as above, compute the total income of the company for the Assessment year 2019-2020. ***(10 Marks)***

3.14 Based on the costing related information provided by Mr. Abhinandanan, Manager (Finance) as above, examine the new quality control proposal and recommend the acceptance or otherwise of the proposal both from financial and non-financial perspectives.

(4 Marks)

3.15 Mr. Daivignay wants to know from you the legal position on certain matters relating to Corporate Social responsibility (CSR) under the provisions of the Companies Act, 2013. Accordingly, in the light of the Companies Act, 2013, advise suitably the following:

(a) Under what circumstances, are the provisions with regard to CSR applicable to Foreign Companies?

(b) Whether an activity which a company is required to do as per its statutory obligations under any law, would be termed as CSR activity?

(c) Whether the provisions of Section 135 of the Companies Act, 2013 is required to be complied by the Company including its Holding or Subsidiary Company? ***(6 Marks)***

ANSWER TO CASE STUDY3

PART – A

3.1 (D)

3.2 (B)

3.3 (D)

3.4 (C)

3.5 (A)

3.6 (C)

3.7 (C)

3.8 (B)

3.9 (C)

3.10 (A)

PART – B

3.11 The income of an assessee for a previous year is charged to income-tax in the assessment year following the previous year.

However, there are few exceptions, in which this rule does not apply and the income is taxed in the previous year in which it is earned. The exceptions are as follows:

(a) **Shipping business of non-resident [Section 172]**

Where a ship, belonging to or chartered by a non-resident, carries passengers, livestock, mail or goods shipped at a port in India, the ship is allowed to leave the port only when the tax has been paid or satisfactory arrangement has been made for payment thereof. 7.5% of the freight paid or payable to the owner or the charterer or to any person on his behalf, whether in India or outside India on account of such carriage is deemed to be his income which is charged to tax in the same year in which it is earned

(b) **Persons leaving India [Section 174]**

Where it appears to the Assessing Officer that any individual may leave India during the current assessment year or shortly after its expiry and he has no present intention of returning to India, the total income of such individual for the period from the expiry of the respective previous year up to the probable date of his departure from India is chargeable to tax in that assessment year.

(c) **AOP/ BOI/ Artificial Juridical Person formed for a particular event or purpose [Section 174A]**

If an AOP/ BOI etc. is formed or established for a particular event or purpose and the Assessing Officer apprehends that the AOP/ BOI is likely to be dissolved in the same year or in the next year, he can make assessment of the income up to the date of dissolution as income of the relevant assessment year.

(d) **Persons likely to transfer property to avoid tax [Section 175]**

During the current assessment year, if it appears to the Assessing Officer that a person is likely to charge, sell, transfer, dispose of or otherwise part with any of his assets to avoid payment of any liability under this Act, the total income of such person for the period from the expiry of the previous year to the date, when the Assessing Officer commences proceedings under this section is chargeable to tax in that assessment year.

(e) **Discontinued business [Section 176]**

Where any business or profession is discontinued in any assessment year, the income of the period from the expiry of the previous year up to the date of such discontinuance may, at the discretion of the Assessing Officer, be charged to tax in that assessment year.

3.12 Section 10 exempts certain incomes. Such incomes are excluded from the total income of an assessee. The incomes which are exempt under section 10 will not be included for computing total income.

On the other hand, Chapter VI-A contains deductions from gross total income. Incomes from which deductions are allowable under chapter VI-A will first be included in the gross total income (GTI) and then the deductions will be allowed from gross total income (GTI).

Further, if there is no gross total income, then no deductions under section VI-A will be permissible.

3.13 Computation of total income of M/s MG Software and Exports Ltd.'s subsidiary for the A.Y.2019-20

	Particulars	Amount (₹)	
I	**Profit and gains from business or profession**		
	Net profit as per the statement of profit and loss		36,50,000
	Add: **Expenditure debited to statement of profit & loss but not allowable as deduction or to be considered separately**		
	- **CSR Expenditure incurred**	2,00,000	
	[CSR expenditure incurred by the company as per the Companies Act, 2013 is not deemed to be an expenditure incurred by the company for the purposes of business or profession. Hence, the same is not allowable as deduction. Since the same has been debited to statement of profit and loss, it has to be added back]		
	- **Donation to registered political party**	70,000	
	[Donation paid to a political party is not an allowable expenditure under section 37 since it is not laid out wholly or exclusively for the purposes of business or profession. Hence, the same has to be added back while computing business income]		
	- **Amount paid towards goodwill to a director**	20,00,000	
	[Goodwill is an intangible asset which is eligible for depreciation and the amount paid for acquisition of a capital asset is not allowable as deduction. Since the same has been debited to the statement of profit and loss, it has to be added back for computing business income]		
	- **Depreciation as per books of account**	13,50,000	
	- **Deferred tax liability**	3,00,000	
	[Deferred tax is an accounting concept and there is no provision in the Income-tax Act, 1961 permitting deduction in respect of the same. Therefore, provision for deferred tax is not an allowable deduction while computing business income. Since the same has been debited to the statement of profit and loss, it has to be added back for		39,20,000

computing business income]		
		75,70,000
***Less:* Items credited to statement of profit and loss, but not includible in business income**		
- **Bad debt recovered**	-	
[The amount of bad debt written off earlier when recovered subsequently, such recovery is taxable under section 41(4). Since the same has been credited to the statement of profit and loss, no further adjustment is required for the same]		
- **Share income in AOP**	1,20,000	
[Since AOP has to pay tax at the maximum marginal rate or a higher rate, company's share in the total income of AOP will not be included in his total income and will be exempt. Since the same has been credited to the statement of profit and loss, the same has to be reduced while computing business income]		
- **Long term capital gain on sale of unlisted shares**	50,000	
[The taxability or otherwise of long term capital gain on sale of unlisted shares has to be considered while computing income under the head "Capital Gains". Since such capital gain has been credited to statement of profit and loss, the same has to be reduced to arrive at the business income.]		
- **Dividend received from domestic companies**	11,00,000	
[The taxability or otherwise of dividend received has to be considered while computing income under the head "Other Sources". Since such dividend has been credited to statement of profit and loss, the same has to be reduced to arrive at the business income.]		
- **Royalty income in respect of patents developed and registered in India**	-	
[Royalty income in respect of patents developed and registered in India is chargeable to tax under section 115BBF can be treated as business income or income from other sources, depending upon the facts of the case. In this case, it is assumed that the same is in the nature of business income. Since the amount of ₹10 lakh has		

	already been credited to statement of profit and loss, no further adjustment is necessary] ***Note***– *In the alternative, the said income of ₹ 10,00,000 may be treated as "income from other sources" and accordingly, reduced the same to compute business income.*		12,70,000
			63,00,000
	Less: Depreciation on Goodwill of ₹20 lakh@25%		5,00,000
	Profits and gains from business and profession		58,00,000
II	**Capital Gains**		
	Long term capital gains on sale of unlisted shares [Chargeable to tax@20% with indexation benefit]		30,000
III	**Income from Other Sources**		
	Dividend from domestic companies	11,00,000	
	Less: Dividend exempt under section 10(34)	11,00,000	-
	Gross Total Income		58,30,000
	***Less:* Deduction under Chapter VI-A**		
	Under section 80GGC [Donation to registered political party, ₹40,000 would be allowed as deduction, since payment is made in a mode other than cash; Donation of ₹30,000, paid in cash, would not be allowable as deduction]		40,000
	Total Income		**57,90,000**

3.14 Implementation of new system will reduce costs of the non - conformance (internal and external failure) by ₹ 5,10,000 (-40%). However, this will also increase costs of conformance by ₹ 6,30,000. There is inverse relationship between the costs of the conformance and the costs of non-conformance. Company should try to avoid costs of non- conformance because both internal and external failure affect *customer's satisfaction and organisations profitability*. The company should focus on preventing the error such that it ensures that product is of good quality when it reaches the customer at the very first instance. This enhances the customer experience and therefore eliminating the scope for external failures like sales returns and warranty claims. Better quality can yield further sales. Therefore, an increase in spending on quality measures provides significant improvements to quality that could be vital in retaining market share and better competitive position.

Accordingly, from the financial perspective point of view the new proposal for quality control should not be accepted as it will lead to an additional cost of ₹ 1,20,000 (₹ 6,30,000 - ₹ 5,10,000). However, from non-financial perspective point of view as stated above the company should accept the new proposal.

3.15 (a) According to Rule 3 of the Companies (Corporate Social Responsibility) Rules, 2014, every company including its holding or subsidiary, and a foreign company defined under clause (42) of section 2 of the Act having its branch office or project office in India, which fulfills the criteria specified in sub-section (1) of section 135 of the Act shall comply with the provisions of section 135 of the Act and these rules.

Provided that net worth, turnover or net profit of a foreign company of the Act shall be computed in accordance with balance sheet and Profit and loss account of such company prepared in accordance with the provisions of clause (a) of sub-section (1) of section 381 and section 198 of the Act.

(b) The MCA vide *General Circular No. 21/2014 dated 18th June, 2014* has provided that expenses incurred by companies for the fulfillment of any Act/ Statute of regulations (such as Labour Laws, Land Acquisition Act etc.) would not count as CSR expenditure under the Companies Act.

Hence, an activity which a company is required to do as per its statutory obligations under any law, would not be termed as CSR activity.

(c) According to Rule 3 of the Companies (Corporate Social Responsibility) Rules, 2014, every company including its holding or subsidiary, and a foreign company defined under clause (42) of section 2 of the Act having its branch office or project office in India, which fulfills the criteria specified in sub-section (1) of section 135 of the Act shall comply with the provisions of section 135 of the Act and these rules.

According to section 135(1) of the Companies Act, 2013, every company having net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during the immediately preceding financial year shall constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director. The criterion needs to be fulfilled by individual company. Therefore, if the holding company or the subsidiary company themselves fulfils the criteria specified in section 135, all the provisions mentioned therein becomes applicable to such company. Merely being a holding or subsidiary company of a company which fulfils the criteria under section 135(1) does not make the company liable to comply with section 135, unless the company itself fulfills the criteria.