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PAPER – 6F: MULTI-DISCIPLINARY CASE STUDY

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

All your workings should form part of your answer.

CASE STUDY -1

Digital Software Ltd., is a professionally managed, profit making, dividend paying, unlisted Public Limited Company incorporated in 2009 under the Companies Act, 1956 having its Registered Office at Coimbatore, Tamil Nadu. The Company operates in 3 units at. Coimbatore and 1 unit at Nagercoil, India, and has 2 subsidiaries in India and 1 wholly owned subsidiary at California, USA called Digital Software Inc., USA.

The Company provides a wide range of services such as consulting services, technology services and outsourcing services in India and to International clients spread across seven continents. The Company's segments are Banking, Financial, Insurance, Education, Hospitality, Health Care, Energy, Utilities, Communication, Logistics, etc. Besides technically qualified personnel, the Company has on its rolls several semi-skilled and unskilled workers as the Company is continuously expanding its operations.

The Company is managed by a broad based Board of Directors who are qualified professionals in information technology, engineering, accounting and finance with more than two decades of experience. The Company is practising good corporate governance in letter and spirit and has earned a good reputation with the shareholders; bankers and customers at large.

Since inception, the Company has maintained proper books of accounts adopting historical cost convention and accrual basis of accounting. All the accounting transactions are in alignment with the generally accepted accounting principles, complying with all significant accounting policies and mandatory Accounting Standards. The books of accounts are duly audited by a reputed firm of Chartered Accountants. The Company is regular in depositing all statutory dues to the Government and there are no pending disputes with any Government agencies. The Income Tax assessments have been completed up to the Assessment Year 2018-19.

The Managing Director (MD) of the Company is of the strong view that utmost care is warranted in ensuring due compliances of various laws and regulations. This strong motive and belief of the MD were duly taken into consideration by all the departmental heads and strict monitoring of the compliances were given top priority by the Audit Committee and the Board of Directors of the company.

After completing two consecutive terms of five years each, the existing firm of Chartered Accountants retired at the conclusion of the Annual General Meeting of the Company held on 14.08.2019 and the shareholders appointed your firm as the Statutory Auditor of the Company for a period of five years on such remuneration as may be mutually agreed upon between you *and the Audit Committee of the Company. Accordingly, you have assumed the office of Statutory Auditor for the financial year 2019-20.*

You were informed that it is the practice of the Company to adopt financial results (both Standalone and Consolidated) on a quarterly basis and therefore your involvement to audit the books of accounts shall be on a continuous basis. You also ascertained that the audited financial results for the quarter ended 30.06.2019 were adopted at the meeting of the Board of Directors held on 10.08.2019.

On 05.10.2019, you were informed by the Director (Accounts and Finance) that a meeting of the Audit Committee and the Board of Directors is scheduled to be held on 22.10.2019 and 23.10.2019 respectively to consider amongst other subjects, inter-alia to approve and take on record the audited financial results of the Company for the second quarter/half year ended 30.09.2019. He also informed you that a week prior to the above meeting dates, an internal meeting with the top management would be scheduled to discuss with you any matter arising out of the audit. The Director (Accounts and Finance) has also submitted to you draft financial statements for the quarter/half year ended 30.09.2019 for audit.

During the course of your audit for the second quarter from O 1.07.2019 to 30.09.2019, you made the following observations:

1. *One of the Company's units located in Nagercoil, had faced severe interruption during the said quarter due to cyclone and floods. Out of total 303 available working days during the whole of the financial year 2019-20, the interruptions during the second quarter of the financial year were:*

   (a) Floods 4 days, (b) Cyclone 3 days, and (c) Damage restoration 2 days (excluding weekly off days falling in between). The unit declared lay-off during such period, on payment of average 50% of salary to its employees. The damage to the computers and other equipments and the cost of its repairs amounted to ₹ 87 lakhs.

   The following expenses were incurred :

	(₹ In lakhs)
Salaries	*1,230*
Power	*820*
Other Fixed Expenses	*490*
Indirect Wages and Salaries·	*740*
Depreciation 210	
Finance Charges 115	

2. *As at 30.09.2019, the Company's investments in subsidiaries are considered as long-term and valued at cost. One of the Indian subsidiary's net worth was fully eroded as at*

30.09.2019 and the prospects of its recovery is very bleak. However, the other two subsidiaries (in India and USA) are doing exceptionally well. The Chief Accounts Officer has informed you that the Company did not provide for the decline in the value of investment in the above subsidiary because the overall investment portfolio in subsidiaries did not suffer any decline in view of the fact that the other two subsidiaries are doing exceptionally well;

3. *Mr. Ramanathan, is a director of F Ltd., and R Ltd. Both companies did not file their financial statements with the Ministry of Corporate Affairs (MCA) for the year ended 31.03.2018. On 01.07.2019 Mr. Ramanathan is-proposed to be appointed as an additional director of Digital Software Ltd. for which company sought a' declaration from Mr. Ramanathan and the same was also submitted by him stating that no disqualification specified in Section 164 of the Companies Act, 2013 is attracted in his case;*

4. *In respect of the 3 units at Coimbatore of the company, ₹ 3 lakhs of employee contribution and ₹ 7.50 lakhs of employer contribution towards Employee State Insurance contribution have been accounted in the books of accounts in respective heads. However, only ₹ 4 Lakhs has been deposited with ESIC department during the second quarter ended 30.09.2019. The Chief Accounts Officer has informed you that due to bank strike for almost a week, they have not deposited the amount due but will deposit the overdue amount along with interest subsequently;*

5. *The Company exchanged surplus land with a book value of ₹ 10 lakhs for cash of ₹ 20 lakhs and plant and machinery valued at ₹ 25 lakhs;*

6. *The Company has re-classified a portion of current investments purchased for ₹ 20 lakhs to 'long term'. The market value as on the date of Balance Sheet was ₹ 25 lakhs;*

7. *The Company purchased high tech computers for US $ 1,00,000 on 01.07.2019 payable after three months and it has entered into a forward contract for three months at US$ 65.70 per dollar. The exchange rate per dollar on 01.07.2019 was US$ 64.70;*

8. *Mr. Nani, a relative of a Key Management Personnel (KMP) of the parent Company received remuneration of ₹ 3,00,000 for his services in the Company for the period 01.04.2019 to 30.06.2019. On 01.07.2019, he left the job;*

9. *The Company launched a new software product in July 2019. The Company (incurred ₹ 20 Lakhs towards research for the same. Due to prevailing market conditions, the management came to the conclusion that the product (cannot be sold in the market for the next 10 years. The management, hence, wants to defer the expenditure write-off to future years.*

   As the Statutory Auditor of the Company, you are required to analyse and answer the following:

Part-A

Provide the correct option to the following questions :

1.1 *On exchange of surplus land with a book value of ₹ 10 lakhs for cash of ₹ 20 lakhs and plant and machinery valued at ₹ 25 lakhs, the measurement of the assets received would be*

(A ₹ 25 Lakhs;

(C) ₹ 20 Lakhs:

(B) ₹ 35 Lakhs;

(D) ₹ 55 Lakhs.

1.2 *On re-classification of the portion of current investments purchased for ₹ 20 lakhs to 'Long Term' on 30.09.2019 where the market value was ₹ 25 lakhs, the investments should be carried at*

(A) ₹ 25 Lakhs;

(B) ₹ 20 Lakhs;

(C) Average of ₹ 25 Lakhs and ₹ 20 Lakhs;

(D) Irrevocable option between ₹ 20 Lakhs and ₹ 25 Lakhs.

1.3 *For the high-tech computers purchased on 01-07-2019, payable after three months and for which company has entered into a forward contract, what is the amount of profit or loss on forward contract ?*

(A) ₹ 1,00,000;

(B) ₹ 60,700;

(C) ₹ 59,700;

(D) ₹ 1,10,000.

1.4 *For the purpose of reporting transactions under AS 18, for the FY 2019-20, Mr. Nani who left the company on 01-07-2019 should be identified as*

(A) A resigned employee;

(B) A related party;

(C) Not a related party as he was not employed for full year;

(D) Not a related party since he is only related to the KMP and not a KMP himself.

1.5 *For accounting of the cost of Research of ₹ 20 lakhs, which is the correct treatment as per the applicable Accounting Standard ?*

(A) The Company has to write off the cost in the current financial year ending 31.03;2020;

(B) The Company can write the cost over a period of 10 years;

(C) The Company can write off the cost over a maximum period of 5 years;

(D) The Company can write off the cost in the year in which the research can be commercially developed. ***(2 x 5 = 10 Marks)***

Part-B

1.6 You have observed that 1 of the Company's units located in a coastal area had faced interruption in production during the second quarter of FY 2019-20 due to cyclone and floods. On the basis of the information provided, find out the abnormal expenses that could be deductible from the product cost. (Assume costs given in point 1 as annual-costs) ***(5 Marks)***

1.7 The Chief Accounts Officer has informed you that the Company did not provide for the decline in the value of investments in the Indian subsidiary because the overall investment portfolio in subsidiaries did not suffer any decline as the other two (Indian .and USA) subsidiaries are doing exceptionally well. Examine whether the contention of the Chief Accounts Officer is correct in the light of AS -13 "Accounting for Investments". ***(4 Marks)***

1.8 In respect of the information provided in point 3 above, examine whether the declaration submitted by Mr. Ramanthan to the Company is in order for his. appointment as an additional director w.e.f. 01.07.2019 ? ***(3 Marks)***

1.9 In respect employee and employer's contribution towards Employee State Insurance contribution for the Company's units 1 to 3, explain whether the contention of the Chief Accounts officer is correct ? If not, state the correct legal position and the obligations of the Statutory Auditor while expressing a qualified or adverse opinion on the financial statements. ***(3 Marks)***

ANSWER TO CASE STUDY 1

PART – A

1.1 (A)

1.2 (B)

1.3 (A)

1.4 (B)

1.5 (A)

PART – B

1.6 Abnormal costs

All costs – variable and fixed are accumulated under a product or service. Proportional costs for abnormal losses are deducted from cost of production of goods/service and charged to the P & L account.

It may be assumed safely that only salaries and Indirect wages are the items affected by the disruption.

303 days p.a. less 9 days of disruption + 4.5 days (since 9 days are paid for at 50%) = 303-9+4.5 = 298.5 days

Amount paid for the disrupted period = 1230/298.5 * 9*50% = 18.54 lacs

Indirect wages = 740/298.5x9x50% = 11.16 lacs

Damage to computers 87 lacs is not tabulated and hence is taken as not even charged to the service or product, since it cannot come under other fixed charges, depn, finance charges.

Depreciation and other expenses (excluding finance charges) are normally taken based on the budgeted fixed costs and normal level of activity as denominator to arrive at the hourly rate to be billed to clients with mark up. However, under product costing, just as we arrive at total factory cost and then adjust for closing stock and abnormal loss, we may consider in services also. But here, depreciation may be considered as being incurred on administrative assets like office equipments, etc.

For fixed expenses, consider a denominator of 303, adjust for the days lost, viz 9 days and then treat it as abnormal loss. i.e. (210+490)/303 x 9 = 20.79.

In the present case, the following expenses are excluded from the total expenses:

(i) The **Finance Charge** is not charged to Cost of Production but is to be shown under the head Cost of Sales.

(ii) **Power** is a direct cost and is excluded from the total expenses. Power would not have been incurred due to disruption.

(iii) **Direct Wages and Salaries** is a variable cost but, in the given situation, the layoff payment was made and hence is treated as fixed cost.

Abnormal expenses calculation:

Particulars	Amount (₹ In lakhs)
Salaries	18.54
Repairs-computers	87.00
Indirect Wages	11.16

Depreciation & fixed exp	20.79
Total abnormal expenses	**137.49**

1.7 Carrying amount of Long-term investments

As per para 18 of AS 13, long-term investments are usually of individual importance to the investing enterprise. The carrying amount of long-term investments is therefore determined on an individual investment basis.

As per the facts given in the question, since the net worth of the Indian subsidiary have been fully eroded, the decline in the value of its shares should be considered as other than temporary.

Hence, its carrying amount should be determined on individual basis and reduced to recognise the decline irrespective of other long term investment giving fairly well results.

The contention of the Chief Accounts Officer is therefore **not tenable**.

1.8 Correctness of the declaration furnished by director

According to section 164(2)(a) of the Companies Act, 2013, no person who is or has been a director of a company which has not filed financial statements or annual returns for any continuous period of **three financial years** shall be eligible to be appointed in other company for a period of five years from the date on which the said company fails to do so.

In the instant case, F Ltd. and R Ltd. in which Mr. Ramanathan is a director did not file their financial statements for the year ended 31.03.2018. The financial statements have not been filed for only one year.

Hence, no disqualification under section 164(2)(a) occurs on Mr. Ramanathan Consequently, declaration submitted by Mr. Ramanathan stating that no disqualification specified in section 164 of the Companies Act, 2013 is attracted in his case **is in order** for his appointment as an additional director of Digital Software Ltd.

1.9 Non-compliance of laws and Regulations & Reporting requirements:

Contributions to ESI

As per SA 250 "Consideration of Laws and Regulations in an Audit of Financial Statement", it is the responsibility of management, with the oversight of those charged with governance, to ensure that the entity's operations are conducted in accordance with the provisions of laws and regulations, including compliance with the provisions of laws and regulations that determine the reported amounts and disclosures in an entity's financial statements.

The auditor is responsible for obtaining reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether caused by fraud or error. In conducting an audit of financial statements, the auditor takes into account the applicable legal and regulatory framework. If the auditor concludes that the non-compliance has a material effect on the financial statements and has not been adequately reflected in the financial statements, the auditor shall express a qualified or adverse opinion on the financial statements. Further, the auditor is required to report under clause (vii)(a) of Para 3 of CARO, 2016 whether the company is regular in depositing undisputed statutory dues including provident fund, employees' state insurance, income-tax, sales-tax, Goods and Services Tax (with effect from July 1, 2017), service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues to the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as on the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated.

In the instant case, contention of Chief Accounts Officer is not correct, disclosure of non-payment is necessary in accordance with clause (vii)(a) of Para 3 of CARO, 2016. Therefore, the auditor is required to disclose the fact of non-payment of rupees 6.50 lakhs in his report

CASE STUDY 2

You are a: partner of a Chartered Accountants' firm with competencies in Audit and Assurance, Domestic and International Taxation, Business Advisory Services, Mergers and Acquisitions, FEMA, Capital Markets, Banking and Finance. You are also known for your sharp acumen on Indian Accounting and Auditing Standards and mandate best reporting practices to a variety of large, reputed, listed companies including multi-national companies in the country.

You always believe that it is your legitimate right to advise your clients to comply with the rule of law, promote transparency in financial .and business transactions, make your clients much more tax compliant vis-a-vis intelligent tax planning rather than tax dodging and tax evasion.

You are always interested in providing suggestions and solutions rather than just discussing problems. You are very often specially chosen and consulted by a variety of large business houses as you possess excellent communication and presentation skills with a sound clarity of thought on the technical aspects of statute or with whatever you advice. You are also a Director on the Board, Chairman and/or Member of Committees of the Board of many listed and unlisted entities.

New Gen Chemicals Limited (NGCL) is one such entity, the flagship Company of Bharat Group having multiple businesses, subsidiaries and associate companies wherein your audit partner provides audit and auxiliary services, taxation and advisory services from time to time on various business related projects, expansion strategies, funding aspects, tax implications etc. The main business of the Company is manufacture of various chemicals used in Textiles, Engineering and other manufacturing industries. The Company is in the business for the last three decades and has carved itself a reputation in the domestic and international markets for its quality production and timely deliveries. The Company has been doing exceptionally good business over the years and has registered a consistent growth year-on-year in terms of turnover and profits.

In view of your excellent technical and presentation skills, you have been much sought after and relied upon by the management of NGCL to provide expert opinions and advices to the management.

During the first week of May 2019, you have been invited with your team for a very confidential meeting with the Chairman, Managing Director and top management executives to discuss issues like appointment of a financial expert to turnaround one of the loss making Associate Company, adoption of Ind AS for preparation of financial statements, disclosures to be made in the financial statements pursuant to Schedule III of the Companies Ad, 2013 and other matters.

On the appointed day, Mr. Gopal, Director Finance, formally welcomed you and your team and after pleasantries, Mr. Gopal discussed the following matters and submitted various facts and figures in support of the discussion.

SUMMARY OF DISCUSSION 1

The Company wants to hire the services of Mr. Ravi, a seasoned financial expert to tum around one of its loss making Associate Company. It is expected that after his appointment, the profits of that associate Company will increase by 10% over and above the targeted profit.

Financial Information of the said subsidiary as on 31.03.2019:

Capital and Reserves	***Amount in ₹***
Equity share capital of ₹ 10 each of which ₹ 8 has been called up	*8,00,000*
Calls-in-Arrears	*1,00,000*
General Reserve	*7,50,000*
50,000, 9% Debentures of ₹100 each	*50,00,000*
Profit/(Loss) for the Year	*(2,50,000)*
Industry average profitability rate	*12.50%*

SUMMARY OF DISCUSSION 2

The following disclosures were extracted from the draft Ind AS financial statements of NGCL which it will adopt in FY 2019-20 :

(i) In the Balance Sheet, the sub-head inventories contained an item "goods in transit" in which a consolidated amount aggregating the cost of raw materials in transit and loose tools billed to company but delivery not made had been specified;

(ii) Provision for doubtful debts of Trade receivables was grouped in, "Provisions" under current liabilities";

(iii) In Statement of Profit and Loss, prior period income was shown under "Other Income"; ·

(iv) Sale proceeds of scrap incidental to manufacture were included in "Other Income";

(v) Payment towards a one-time voluntary retirement scheme introduced during the year was included in "Employee Benefit Expense".

SUMMARY OF DISCUSSION 3

The Income Tax Assessing Officer, in the current financial year 2019-20 observed, during the assessment proceedings, a need to re-open the accounts of the Indian subsidiary for the financial year 2014-15 and therefore filed an application before the National Company Law Tribunal (NCLT) to issue an order to the subsidiary for re-opening its accounts and recasting the financial statements for the financial year 2014-15.

SUMMARY OF DISCUSSION 4

Other matters concerning year end finalization :

(i) The Company sold goods for f 90 lakhs to XYZ Ltd. during the financial year ended 31.03.2019. The Managing Director of the Company owns 100% of XYZ Ltd. The sales were made to XYZ Ltd. at normal selling prices followed by the Company. The Chief Accountant of the Company is of the opinion these sales do not require a different treatment from the other sales made by the Company and hence no disclosure of related party transactions is necessary as per the Accounting Standard -18 (AS -18);

(ii) The Company has purchased debentures off 15 lakhs which are redeemable within 6 months;

(iii) The Company sold its building for f 65 lakhs to A Ltd. and has also given the possession of the same. The book value of the building is ₹ 30 Lakhs. As on 31.03.2019, the documentation and legal formalities are pending;

(iv) The Company had an existing freehold factory property. During the financial year 2018-19, it knocked down and re-developed the property. During the redevelopment period, the Company moved its production facilities to a new temporary site and incurred ₹ 23 Lakhs towards rent, installation of machinery costs, removal of machinery and transportation costs from the old location to the new location;

(v) The Government of Tamil Nadu, in order to encourage industrial promotion, offered subsidy of ₹ 50 Lakhs in the nature of promoters' contribution to all new industries set up in the specified industrial areas. The Company had recently set up its new factory in the specified industrial area and received the subsidy.

After receipt of the above information submitted by Mr. Gopal you are expected to analyse and present a report to the management.

Part-A

Provide the correct option to the following questions :

2.1 In the light of the information given in the summary of discussion .4(i), the opinion of the Chief Accountant is

(A) Wrong as AS-18 disclosures are applicable;

(B) Correct as the sales was made at normal selling price;

(C) Correct as AS-18 does not apply;

(D) Correct if disclosure is made in the report of Board of Directors.

2.2 For the purchase of debentures as given in the summary of discussion 4(ii), while preparing the cash flow statement as per AS-3 for the half year ended 30.09.2019, the same will be shown under:

(A) Cash Outflow in Operating Activities;

(B) Cash Outflow in Financing Activities;

(C) Cash Outflow in Investment Activities;

(D) Cash and Cash Equivalents.

2.3 In the light of the information given in the summary of discussion 4(iii), for the financial year ended 31-03-2019:

(A) The Company should make mention of sale in Directors' Report;

(B) The Company should recognize the profit off 35 Lakhs in its Reserves;

(C) The Company should not record the sale;

(D) The Company should record the sale and recognize profit off 35 lakhs in its statement of profit and loss.

2.4 In the light of the information given in the summary of discussion 4(iv), such costs can be

(A) Capitalised to the cost of new building;

(B) Accumulated under the head "Property redevelopment expenditure" and amortised over a maximum period of 5 years;

(C) Charged to Profit and Loss Account as and when incurred;

(D) Charged to Profit. and Loss Account in the year the redeveloped property is put to use.

2.5 In the light of information given in the summary of discussion 4(v), the subsidy, as per AS 12 on 'Accounting for Government Grants', will be

(A) Credited to capital reserve;

(B) Credited as 'Other Income' in the Statement of profit and loss;

(C) Credited to general reserve;

(D) Can be either credited to Capital Reserve or credited to 'Other Income' in the statement of profit and loss. ***(2 x 5 = 10 Marks)***

Part-B

2.6 *What is the maximum salary that. could be offered to Mr. Ravi to tum around the loss making Associate Company ?* ***(5 Marks)***

2.7 *Give your comments on the disclosures (as, extracted) made by the Company in its draft financial statements under Ind AS.* ***(5 Marks)***

2.8 *In the light of the information given in summary of discussion 3 above, examine the validity of the application filed by the Income Tax Assessing Officer before the NCLT.* ***(5 Marks)***

ANSWER TO CASE STUDY 2

PART – A

2.1 (A)

2.2 (C)

2.3 (D)

2.4 (C)

2.5 (A)

PART – B

2.6 Calculation of Capital base and expected profits

Particulars	**₹**
Equity Share Capital paid up (8,00,000 shares of ₹ 8 each)	64,00,000
Less: Calls in arrears	(1,00,000)
	63,00,000
General Reserve	7,50,000
Loss for the year	(2,50,000)
9% Debentures	50,00,000
Capital base	1,18,00,000
Target Profit 12.5% of capital base	14,75,000

Expected profits to be achieved by taking the services of Mr. Ravi is ₹ 16,22,500 (i.e. 14,75,000 + 10% of 14,75,000).

Therefore, the maximum salary that can be paid to Mr. Raman will be ₹ 16,22,500 p.a.

Note: The above solution is given on the basis that 10% expected profit is over the target profit of 12.5%. Alternatively, it can be interpreted that 10% profit is in addition to 12.5% target profit. In such a situation, 22.5% profit on capital base will be the expected profit to be achieved due to hiring of Mr. Ravi would be ₹ 26,55,000 (ie ₹ 1,18,00,000 x 22.5%).

2.7 Comments on disclosures (as extracted) made by the company from the draft financial statements under Ind AS:

(i) As per Division II of Schedule III (for Ind AS based Financial Statements), a separate sub-head 'goods in transit' under inventories should not be created. Goods in transit related to raw material should be included under the sub-head 'raw material' and billed but not delivered loose tools should be included under the head 'loose tools' separately.

This would be as follows:

Notes to Accounts for Inventories

(i) Raw Material ₹ .....

(It includes raw materials in transit Rs .....)

(ii) Loose Tools ₹ .....

(It includes loose tools ₹ .... billed to company but delivery not made.)

(ii) The term doubtful debts is an adjustment to the carrying amount of assets, hence no provision is created separately for it. As per Division II of Schedule III (for Ind AS based Financial Statements), provision for doubtful debts should be deducted from gross amount of trade receivables after disclosing all the categories of trade receivables rather than including it under provisions under current liabilities.

Notes to Accounts on Trade Receivables

Trade receivables (net)	₹ XXXX	
Break up		
Secured, considered good (gross)	xxx	
Unsecured, considered good (gross)	xxx	
Trade receivable which have significant increase in credit risk (gross)	xxx	
Trade receivable - credit impaired (gross)	xxx	
		xxx
Less: Provision for bad and doubtful debts)	**xxx**	
Net trade receivables	XXX	

(iii) Under Ind AS, there is no concept of 'Prior period items'. In case any error related to prior period is detected during the current year, then an entity shall correct such material prior period errors retrospectively in the first set of financial statements approved for issue after their discovery by:

(a) restating the comparative amounts for the prior period(s) presented in which the error occurred; or

(b) if the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented.

Since in the question it is not mentioned that prior period income pertains to which accounting year, it is **assumed** that it relates to previous year. Therefore, comparative amounts shall be restated. Thus, showing prior period income under current year's 'other income' is **not in accordance with Ind AS 8**.

(iv) As per Guidance Note on Division II of Schedule III, sale of manufacturing scrap arising from operations for a manufacturing company should be treated as 'other operating revenue' since the same arises on account of the company's main operating activity. Therefore, presenting it under 'other Income' is **not a correct treatment**.

(v) Employee benefits include termination benefits. Payment made during the year towards one-time voluntary retirement scheme is in the nature of termination benefits. Hence, it should be shown by an entity under employee benefit expenses only. Thus, the treatment done by the company is correct.

2.8 Reopening the books of account

According to **Section 130 of the Companies Act, 2013**, a company shall not re-open its books of account and not recast its financial statements, unless an application in this regard is made by the Central Government, the Income-tax authorities, the Securities and Exchange Board, any other statutory regulatory body or authority or any person concerned and an order is made by a Court of competent jurisdiction or the Tribunal to the effect that—

(i) the relevant earlier accounts were prepared in a fraudulent manner; or

(ii) the affairs of the company were mismanaged during the relevant period, casting a doubt on the reliability of financial statements.

It also provides that the accounts so revised or re-cast as above shall be final.

However, no order shall be made by the Court or the Tribunal in respect of re-opening of books of account relating to a period **earlier than eight financial years immediately preceding the current financial year**.

In the instant case, the application has filed by the Income-tax Assessing Officer before the NCLT in the current year 2019-20 to issue an order to the Indian subsidiary for re-opening its accounts and recasting the financial statements for the financial year 2014-15.

The application filed is related for a period earlier than eight financial years immediately preceding the current financial year i.e. 2019-20.

The **application filed by Income Tax Assessing Office is valid.**

CASE STUDY 3

You are 'advising companies in mergers and acquisitions. One of your clients, T Limited reached out to you with their interest in acquiring companies for their inorganic growth. They have provided you with an analysis of their initial target list along with some business insights obtained through various channels. You are required to consider the details below and answer the questions.

Paper Board Private Limited

The promoters of this company are Zak & Jill who holds about 90% in the company. The remaining 10% is held by a group of minority shareholders of which 9% is held by Johnson in his individual capacity. Whilst the promoters of the company are willing to offload their shares completely at a fair price, Johnson, being a significant minority shareholder, may be creating problems and he may also demand higher price to capitalise on the opportunity.

Johnson is also in the board of the Company and has issues with the Board Chairman on various matters. He has also written to the Registrar of Companies (RoC) that the matters discussed by him in the board meetings are filtered by the Chairman and the minutes do not reflect the facts and the key discussion matters appropriately. Zak is the Chairman of the Board and he believes that his decision is final with respect to board minutes and even the RoC has no role to play.

Further, the promoters believe that any offloading can happen only based on fair terms and after a comprehensive company analysis by an independent party using the well-established statistical techniques.

Innovative Papers Limited

Innovative Papers is the market leader in introducing innovation in the paper industry. The advanced 30 printing capable new generation machineries are imported by the Company which has helped the company in cutting its cost considerably and improving its profitability. Post introduction of Goods and Service Tax (OST), the Company has resorted to certain practices which were challenged by the Department. Several OST refunds received by the Company from the Goods and Service Tax department were alleged to be failing the principle of unjust enrichment under the Act. The exposure arising out of the same needs careful evaluation.

Further, the company is also having several issues with respect to supply and reversals/returns and the process of invoicing/raising of credit and debit notes requires complete overhaul. It has paid OST on several supplies without considering the subsequent reversals resulting in over payment of taxes since it was not clear on the provisions. Further, the time limits for claiming refunds of excess tax paid/unutilised Input credit also requires evaluation since this could have a significant impact on the net worth of the company;

Digital Papers

Digital Papers is a partnership firm where George and Jolly are the current partners. Earlier Michael was also a partner, who retired on 31.03.2018. The firm primarily focuses on exports and has got good recoveries over the past 2 years.

Majority of the exports of the firm were routed through a third party under the deemed exports category which was challenged by the GST authorities recently. The firm has also been slapped with a tax notice on their supplies made in financial year 2017-18 which if confirmed would virtually result in wiping out all the net worth and the partners may have to pay from their personal assets in view of their joint and several liability.

George and Jolly believe that if there is a requirement to pay. the tax, then Michael would also be required to pay the same as per the applicable provisions, though Michael challenges this position. In view of the tax uncertainty, the· firm is willing to consider a total buy out by any large company .

Part-A

Answer the following questions :

3.1 Presume that T Limited proposes to pursue amalgamation of Paper Board Pvt. Ltd. and pursuant to the same, agrees to pay higher price (higher than the price decided under the scheme) to Johnson based on his negotiation, the extra amount/compensation received by Johnson shall be

(A) Fully payable to him in his individual capacity;

(B) Full payable to the remaining minority shareholders;

(C) Allocated to all minority shareholders on pro rata basis;

(D) Allocated to all majority shareholders on pro rata basis.

3.2 Zak has an absolute discretion to exclude the matters raised by Johnson in the board minutes, if it

(A) is relevant or material to the proceedings;

(B) is detrimental to the interests of the Chairman;

(C) is or could reasonably be regarded as defamatory of any person;

(D) is a dissent in a majority decision.

3.3 The OST liability of Innovative Papers Ltd. as a supplier will reduce when the

(A) Credit note is issued by the supplier;

(B) Credit note is issued by the customer;

(C) Debit note is issued by the supplier; (

(D) Debit note is issued by the customer.

3.4 Michael, the retired partner in Digital Papers is liable to pay GST, interest and penalty of the firm due :

(A) Till the date of the retirement not withstanding any intimation to Commissioner;

(B) Till the date of the intimation provided to the commissioner;

(C) Indefinitely notwithstanding the retirement/intimation;

(D) Not at all liable post retirement.

3.5 The time limit for making an application for claiming refund of OST taxes paid by Innovative Papers Ltd. is

(A) 3 years from the relevant date;

(B) 2 years from the relevant date;

(C) None since there is no time limit;

(D) None since such refund can never be claimed. ***(2 x 5 = 10 Marks)***

Part-B

Answer the following :

3.6 How will you carry out the company analysis of Paper Board Private G Limited using the statistical techniques ? ***(8 Marks)***

3.7 Under what circumstances Innovative papers limited is legally- entitled to the OST refunds and can also retain such amounts without having the requirement to pass it on to anybody else ? ***(7 Marks)***

ANSWER TO CASE STUDY 3

PART – A

3.1 (C)

3.2 (C)

3.3 (A)

3.4. (A) and (B)

Option (A) will be correct if the question is answered in the context of the specific demand notice issued on Digital Papers (in accordance with the facts given in the case study) as the tax demand pertains to the period when Michael was partner in Digital Papers. The retiring partner is invariably liable to pay the tax dues of the firm till the date of his registration; his liability, however, extends beyond his date of resignation if he submits the intimation of his resignation to the Commissioner after 30 days from the date of his resignation.

Option (B) will be correct if the question is answered generally on the basis of the provisions of section 90 and it is assumed that no intimation has been given by the Michael of his retirement to the Commissioner, as the case study does not contain any information regarding the same.

3.5 (B)

PART – B

3.6 Statistical techniques to be used

Company-wide analysis of Paper Board Private Limited can be performed through use of various statistical techniques including:

Correlation & Regression Analysis: Simple regression is used when inter relationship covers two variables. For more than two variables, multiple regression analysis is followed wherein, the inter relationship between variables belonging to economy, industry and company are found out.

The main advantage in such analysis is the determination of the forecasted values along with testing the reliability of the estimates.

Trend Analysis: Trend analysis evaluation can be used to judge the company's financial information over a period of time. Periods may be measured in months, quarters, or years, depending on the circumstances. The objective is to calculate and analyze the amount change and percent change from one period to the next.

Such trend analysis can also be used to predict the company's future sales, future profits, etc., based on the past trends of the said figures, where there have been no abnormal swings.

Decision Tree Analysis: Information relating to the probability of occurrence of the forecasted value is considered useful. A range of values of the variable with probabilities of occurrence of each value is taken up. The limitations are reduced through decision tree analysis and use of simulation techniques.

Additionally, the entity could consider fundamental analysis involving examination of the economic and financial aspects of the Company with the aim of estimating future earnings and dividend prospects/ group analysis which involves evaluation of financial health and promise vs performance of the group company for their analysis.

3.7 Dealing with the refund under GST

The refundable amount under GST shall, instead of being credited to the Consumer Welfare Fund, be paid to Innovative Papers Limited, and the company can retain the same without having to pass it on to anyone else, if such amount is relatable to —

(a) refund of tax paid on export of goods or services or both or on inputs or input services used in making such exports;

(b) refund of unutilized ITC in case of zero rated supplies made without payment of tax or accumulated ITC on account of inverted duty structure;

(c) refund of tax paid on a supply which is not provided, either wholly or partially, and for which invoice has not been issued, or where a refund voucher has been issued;

(d) refund of tax in pursuance of section 77 of the CGST Act, 2017, i.e. tax paid on a transaction treated to be an intra-State supply, but which is subsequently held to be an inter-State supply or vice-versa.;

(e) the tax and interest, if any, or any other amount paid by Innovative Papers Limited, if it had not passed on the incidence of such tax and interest to any other person; or

(f) the tax or interest borne by such other class of applicants as the Government may, on the recommendations of the Council, by notification, specify [Section 54(8) of the CGST Act, 2017].

CASE STUDY 4

A retired professor is running a free coaching centre for professional exams and you are assisting him for the same. The service is well recognised by the student community. As part of preparation for the examinations, the professor has organised a doubt removal session for 2 days where the students can raise any question from any subject and the answers will be provided.

Giving below the list of questions raised by 3 students Shah, Kumar and Patel.

Shah

Shah had a doubt regarding the security cover available for settling the workmen's dues under the applicable statute. If the available securities are already charged to the secured creditors who have given loans to the company in excess of the value of the available securities, how the workmen's due claims would be settled ? He is not ab1e to understand the concept of security for workmen dues under such scenario and is not clear regarding the type of dues that would be considered as workmen's dues for this purpose.

Shah also raised the issue that unless the auditors complete the audit of the financial statements, technically the board will not have the required comfort to approve the financial statements. However, the board has to approve the financials before auditors can sign it formally. He was wondering how it would be possible to address both these requirements.

He raised his next query on the matter relating to Joint Auditors. When there are 3 joint auditors appointed to audit the company, and if there is difference of opinion amongst the joint auditors, what would be the way forward for reporting by the joint holders ? Shah is confused as regards the requirement of the Companies Act, 2013 and the requirements of the auditing standards issued by the ICAI. He believes that any difference of opinion amongst the joint auditors needs to be decided based on majority decision similar to that of the judiciary.

Kumar

Kumar's question was relating to the extent of examination required by the statutory auditor of a Company for CARO reporting purposes as regards cost records. Since the statutory auditor is only a chartered accountant, he was not sure of how such a review of cost records is possible? He believes that for CARO purposes, the chartered accountant either by himself or through a specialist should conduct a detailed review of cost records to ensure that the records as prescribed are made and maintained.

He was also not clear on the Companies Act provisions relating to the court's jurisdiction to interfere with the internal management of the company when they are acting within their powers. He believes that there are no restrictions for the court and it can interfere at any time suo moto or based on a reference notwithstanding the internal management's actions.

Patel

Patel raised a query relating to the CSR provisions under the Companies Act, 2013 and its applicability to a company which is formed with charitable objects. He believes that the CSR provisions are equally applicable to such companies, however he was not sure of the same.

Patel raised his second question relating to accounting of Certified Emission Reductions (CERs). He wants to know the point of accounting of CERs when the emission reduction activities have taken place awaiting CE₹

You are required to assist the professor by drafting answers to the questions (as summarised below) of the above students.

Part-A

Provide the correct option to the following questions.

4.1 With respect to the question raised by Shah, if the value of the security of a secured creditor of a Company is ₹ 60 Lakhs (who has funded the company to the extent of ₹ 100

Lakhs which remains as outstanding) and the workmen's dues is ₹ 50 Lakhs, the workmen's portion of the security will be

(A) Nil;

(B) ₹ 50 Lakhs;

(C) ₹ 20 Lakhs;

(D) ₹ 60 Lakhs.

4.2 As regards the issue raised by Shah regarding the approval of the financial statements, if the auditors completed the audit and obtained al! the required audit evidence to support the audit opinion on the financial statements on 10.04;2019 and the Board approved the financial statements on 15.04.2019, the date of the signoff by the auditors would be :

(A) On or after 10.04.2019;

(B) On or after 15.04.2019;

(C) Before 10.04.2019;

(D) Before 15.04.2019.

4.3 For a company which is formed with charitable objects, CSR provisions under the Companies Act, 2013 are :

(A) Not Applicable;

(B) Applicable.

(C) Applicable when it makes profits in excess of ₹ 1 crore;

(D) Not Applicable with prior approval of the Registrar of Companies.

4.4 Kumar's view as regards the statutory auditor's review ·of cost records for CARO reporting is :

(A) Correct since it is required under the Companies Act;

(B) Not correct since the requirement is to conduct only a general and broad review;

(C) Based on the facts and circumstances;

(D) Based on mandate of the shareholders.

4.5 · When emission reduction has taken place pending issue of CERs :

(A) CERs receivable is to be accrued in the books;

(B) CERs receivable should not be accrued in the books;

(C) CERs receivable to be treated as contingent asset and accrued in the books;

(D) CERs receivable to be treated as constructive asset and accrued in the books.

(2 x 5 = 10 Marks)

Part-B

4.6 In your view what are the responsibilities of the Joint Auditors appointed under the Companies Act, 2013 with respect to division of work, reliance on the work carried out by other joint auditors, treatment of difference of opinion amongst the joint auditors. Also, explain if there is any rationale for the confusion of Shah regarding the responsibility of Joint Auditors between the Companies Act, 2013 and the auditing standards issued by ICAI ? ***(9 Marks)***

4.7 What is your assessment of Kumar's view as regards the ability of the courts under the Companies Act, 2013 to interfere with the internal management of companies acting within their powers. ***(6 Marks)***

ANSWER TO CASE STUDY 4

PART – A

4.1 (C)

4.2 (B)

4.3 (B)

4.4 (B)

4.5 (C)

PART – B

4.6 Responsibilities of the Joint Auditors

SA 299 on, "Joint Audit of Financial Statements" deals with the professional responsibilities, which the auditors undertake in accepting such appointments as joint auditors. In respect of the work divided amongst the joint auditors, each joint auditor is responsible only for the work allocated to him, whether or not he has made a separate report on the work performed by him. On the other hand the joint auditors are jointly and severally responsible in respect of the audit conducted by them as under:

(i) in respect of the audit work which is not divided among the joint auditors and is carried out by all joint auditors;

(ii) in respect of decisions taken by all the joint auditors under audit planning in respect of common audit areas concerning the nature, timing and extent of the audit procedures to be performed by each of the joint auditors;

(iii) in respect of matters which are brought to the notice of the joint auditors by any one of them and on which there is an agreement among the joint auditors;

(iv) for examining that the financial statements of the entity comply with the requirements of the relevant statute;

(v) for ensuring presentation and disclosure of the financial statements as required by the applicable financial reporting framework;

(vi) for ensuring that the audit report complies with the requirements of the relevant statutes, the applicable Standards on Auditing and the other relevant pronouncements issued by ICAI.

(vi) it is the separate and specific responsibility of each joint auditor to study and evaluate the prevailing system of internal control relating to the work allocated to him, the extent of enquiries to be made in the course of his audit;

(vii) the responsibility of obtaining and evaluating information and explanation from the management is generally a joint responsibility of all the auditors;

(viii) each joint auditor is entitled to assure that the other joint auditors have carried out their part of work in accordance with the generally accepted audit procedures and therefore it would not be necessary for joint auditor to review the work performed by other joint auditors.

Where, in the course of the audit, a joint auditor comes across matters which are relevant to the areas of responsibility of other joint auditors and which deserve their attention, or which require disclosure or require discussion with, or application of judgment by other joint auditors, the said joint auditor shall communicate the same to all the other joint auditors in writing prior to the completion of the audit.

Difference of opinion among Joint Auditors

Normally, the joint auditors are required to issue common audit report, however, where the joint auditors are in disagreement with regard to the opinion or any matters to be covered by the audit report, they shall express their opinion in a separate audit report.

A joint auditor is not bound by the views of the majority of the joint auditors regarding the opinion or matters to be covered in the audit report and shall express opinion formed by the said joint auditor in separate audit report in case of disagreement. In such circumstances, the audit report(s) issued by the joint auditor(s) shall make a reference to the separate audit report(s) issued by the other joint auditor(s). Further, separate audit report shall also make reference to the audit report issued by other joint auditors. Such reference shall be made under the heading "Other Matter Paragraph" as per Revised SA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report".

Duty to comply with Auditing Standards

As per sub-section (9) of section 143 of the Companies Act, 2013, every auditor shall comply with the auditing standards. Therefore, so far as the concept of "joint audit" is concerned, Companies Act, 2013 and Auditing Standards stand on same footing.

4.7 Interference of Courts in internal management of companies

Kumar is of the view that there are no restrictions for the Court to interfere in the internal management of a company under the provisions of the Companies Act, 2013. He believes that a Court can interfere any time *suo motu*, or on a reference, notwithstanding internal management's actions.

I **do not agree of Kumar in its entirety**. His view is only partially correct, as explained hereinbelow.

Corporate law works on the principle of democracy and it becomes more vulnerable because it is reckoned with the number of shares and not with the number of individuals involved. This is known as the famous **'Rule of Majority'** or which is also called the '**Foss v. Harbottle**' Rule, which is a landmark judgment in the history of company law.

It states that the ones who hold majority of shares "rule" the company (Foss v. Harbottle (1843) 2 Hare 461). The judgment held that if the majority shareholders have made a decision to take or not to take a certain action, it shall be respected. Also, the courts are not expected to ordinarily intervene to protect the minority interest affected by resolution.

However, the said rule has 4 exceptions, which are as follows –

- *Ultra-vires* or illegal acts;
- Transactions requiring special majorities;
- Personal Rights; and
- The "fraud on the minority" exception.

[**Note:** This issue is also covered in the Case Laws namely Birch v. Sullivan; Jhajharia Brothers' and Rajeev Saumitra vs Neetu Singh & Ors]

CASE STUDY 5

Jwala Mills Limited is a fast growing listed company focusing on bringing innovation in the chemical manufacturing industry. The company has grown by 4 times during past 3 years in terms of revenue and 2 times in terms of profitability. The management is interested in inorganic growth and hence started hunting for suitable targets for acquisition. Based on the inputs provided by various consultants/advisors, the following companies have been short listed for potential buyout possibilities along with a SWOT analysis. The management of Jwala has reached out to you with this list and has asked for your inputs on certain specific matters which could significantly influence their decision.

Clean and sweep Limited

The company was incorporated in 1967 by the erstwhile Johar Group and is currently managed by Panna & Panna. It has its own customers who are very loyal and continue their relationship with the company for several years. Clean and Sweep could not grow beyond those customers *and is finding it difficult to add new customers. Whilst the traditional customer Segment gives premium for their products, the few new customers added by the Company during the past 4 to 5 years did not fetch enough margins. The management of the company believes that since Customer Lifetime Value (CL V) of the company for all its customers is positive, the valuation should reflect the same.*

Further, Clean and Sweep also deals with variety of securitisation instruments, derivative instruments and interest rate swaptions as part of their financial management. The company is able to make sizable income on account of treasury activities.

Swatch Limited

Swatch is a leading player in the industry and has received several awards for modernisation of the plant, Talent recognition etc. The board of the company has eminent directors with enough experience in the industry. It is also worth noting that the company has a profit sharing and bonus plan to its employees which is accounted as an appropriation of profit.

Further, Swatch typically purchases traded goods from Olympic Traders, a wholesaler and sells these goods to the third party without carrying any associated inventory risk as it purchases goods from the wholesaler only when it receives back to back orders from the end customer. However, it may bear the risk of those inventory items that have been returned by the customers.

The company was raided by the income tax department recently. and there were several allegations of unaccounted income/overstatement of expenditure etc. Some of the matters arising out of the income tax raid are

(i) Payment of secret commission by the Company;

(ii) Non-accounting of ₹ 30 crores received from the competitor for not pursuing the digital business for the next 5 years;

(iii) Non-payment of interest on GST amounting to ₹ 50 Lakhs which was claimed as a deductible expenditure in FY 2018-19;

(iv) An amount of ₹ 4 crores was paid to George, a non-resident based out Netherlands, without deducting any truces, towards commission for getting orders from certain customers based out of Netherlands;

(v) Claiming the Bank Guarantees provided to the Pollution department as a deductible expenditure on an environmental matter pending before the Green Tribunal;

(vi) Over paying the inflated supplier bills after due deduction of taxes and getting back part of the amount in cash from the suppliers for ensuring smooth conduct of business.

Whilst the business prospects are attractive, the implications of the income true raid are concerning to the management.

Guru Limited

Guru is having a decentralised set up and has 5 plants and 8 branches in multiple locations in the country. The Company is aggressively expanding is size and scale by acquiring several small entities/ operations. Now with the increased debt in the balance sheet, the management is willing to· offload a share not exceeding 49% to interested third parties.

The management is also seriously exploring the options of outsourcing its administrative, finance, HR and IT activities to a third party service provider and focus more on the core activities.

Dead Wood Private Limited

Dead Wood was a flagship company 15 years back. However due to various issues associated with the management, the company was making continuous losses and it had shut down all its plants and remained inactive for the past 5 years without having any activity. Whilst the company remained dormant, several procedural compliances relating to Companies Act, 2013 including filing of financial statements; other returns etc. were also not complied with. Further, the company has not rotated its auditors post the amendments made to the Companies Act, 2013 even though its '. auditors, M/s. Black & White Associates were continuing since inception.

You are required to review the above matters carefully and answer the following questions:

Part-A

Provide the correct option to the following questions

5.1 CLV of Clean and Sweep denotes the :

(A) · Net present value of the projected cash flows from a lifetime of customer relationship;

(B) Fair value of the past cash flows generated based on a customer relationship;

(C) Net present value of the projected profits from the present customer relationship;

(D) Historical intangible value of the customer relationship.

5.2 Clean and Sweep is dealing with the interest rate Swaption which is

(A) an option on an interest rate swap;

(B) an option on an swap;

(C) an option on a collar;

(D) an option on the interest in the property.

5.3 Black & White Associates, the auditors of Dead Wood Private Limited need not retire by rotation. The aforesaid statement is :

(A) False;

(B) Depends on the decision of the Board;

(C) Depends on the decision of the shareholders;

(D) True.

5.4 The cost of profit sharing and bonus plan for the employees of Swatch is

(A) In the nature of distribution of profit and hence an appropriation;

(B) In the nature of an expense;

(C) In the nature of contingent liability which may arise in future;

(D) In the nature of human resource asset.

5.5 Swatch should reflect _________ as its revenue in accordance with the applicable accounting standards :

(A) Proportionate amount of its billings to its customers derived based on risk assessment;

(B) Gross Billing to its customers;

(C) Net differential margin arising out of its billings to its customers;

(D) Zero. ***(2 x 5 = 10 Marks)***

Part-B

5.6 Evaluate the matters arising out of the income tax raid of Swatch and its allowability under the Income Tax Act, 1961. ***(6 Marks)***

5.7 What would be typical categorisation of various securitisation instruments handled by Clean and Sweep ? ***(5 Marks)***

5.8 Provide your inputs in evaluating the outsourcing proposal of Guru duly considering its pros and cons. ***(4 Marks)***

ANSWER TO CASE STUDY 5

PART – A

5.1 (A)

5.2 (A)

5.3 (D)

5.4 (B)

5.5 (B)

PART – B

5.6 Treatment and allowability of certain unaccounted income/overstated expenditure noticed in income-tax search

(i)	**Secret commission payment not accounted** This is an unaccounted expenditure and hence will be added to the income of the assessee under section 69C of the Income-tax Act, 1961. An unaccounted expenditure can never be claimed as deduction. In any case, even before section 69C is invoked by the Assessing Officer, such expenditure is hit by *Explanation* to section 37(1) owing to which payment of secret commission by Swatch Ltd., if it is established as a payment for any purpose which is an offence or which is prohibited by law, cannot be allowed as deduction.[1]
(ii)	**Non-compete fees of ₹ 30 crores received, not accounted for, in the books** As per section 28(va), any sum received under an agreement for not carrying out any activity in relation to any business / profession (i.e., non-compete fee) is chargeable to income-tax under the head "Profits and gains of business or profession". The assessee had failed to record this receipt in the books. Non-compete fee received is taxable under the head "Profits and gains of business or profession" and hence, the unaccounted income unearthed in the raid/search will be brought to tax under the provisions of the Act.
(iii)	**Interest under GST law, not paid, claimed as expenditure** The issue to be considered is whether the interest on GST will have to be treated as GST for attracting disallowance u/s 43B as the actual payment has not been made before the due date for filing the return of income. There are two views in this regard on the basis of decided court rulings on the above issue. On the basis of the Calcutta High Court ruling in *CIT vs. Padmavati Raje Cotton Mills Ltd. (1999) 155 CTR 540*[2], interest on sales tax cannot be treated as sales tax and hence, disallowance under section 43B is not attracted in respect of such interest.

[1] It was so held in *Tarini Tarpauline Productions v. CIT (2002) 254 ITR 495 (Ori.)*.

[2] following the ratio of the decision of the High Court in *Hindustan Motors Case (1996) 132 CTR (Cal) 472: (1996) 218 ITR 450 (Cal)*

	However, the Rajasthan High Court in the case of *Mewars Motors case (2003) 260 ITR 218* held that such interest is also to be treated as sales tax, and hence, disallowance u/s 43B would be attracted.
(iv)	**Payment to Mr. George, a non-resident without deduction of TDS** Commission income of Mr. George, a non-resident, who remains outside India, for getting orders from customers located outside India is not subject to tax in India, since the non-resident renders services from outside India. Hence, the provisions of section 195 are not attracted in respect of commission paid to Mr. George. Consequently, disallowance under section 40(a)(i) is not attracted in respect of payment of commission to such non-resident outside India since there is no obligation to deduct tax at source in the first place. Thus, the amount of ₹ 4 crores remitted to Mr. George outside India as commission is an allowable deduction in computing the business income.
(v)	**Bank Guarantee furnished to Pollution department** The fee payable to the Pollution Control Department has been claimed as a deduction. Actual payment has not been made, but only bank guarantee appears to have been furnished to the Pollution Department Disallowance under section 43B would be attracted since furnishing of bank guarantee cannot be equated to actual payment. Hence, deduction cannot be claimed merely on furnishing of bank guarantee.
(vi)	**Overstatement of expenditure** As per section 37, any expenditure laid out or expended wholly and exclusively for the purpose of the business or profession would be allowed as deduction. However, Swatch Ltd has inflated the bills and claimed the inflated payment as expenditure. Inflated amount is not expended for the purpose of business or profession, but received back in cash and hence, the same is disallowed while computing business income.

5.7 Securitized instruments handled by Clean and Sweep

This can be divided into three categories based on different maturity characteristics which are as under:

(1) Pass Through Certificates (PTCs)

Originator (seller of the assets) transfers the entire cash in form of interest or principal repayment from the assets sold. Thus, these securities represent direct claim of the investors on all the assets that has been securitized through SPV.

Since all the cash flows are transferred the investors carry proportional beneficial interest in the asset held in the trust by SPV.

Since it is a direct route, any prepayment of principal is also proportionately distributed among the securities holders. Further, due to these characteristics on completion of securitization by the final payment of assets, all the securities are terminated simultaneously.

Skewness of cash flows occurs in early stage if principals are repaid before the scheduled time.

(2) Pay Through Security (PTS)

Since, in PTCs all cash flows are passed to the performance of the securitized assets. To overcome this limitation and limitation to single mature there is another structure i.e. PTS.

In contrast to PTC in PTS, SPV debt securities backed by the assets and hence it can restructure different tranches from varying maturities of receivables.

In other words, this structure permits desynchronization of servicing of securities issued from cash flow generating from the asset. Further, this structure also permits the SPV to reinvest surplus funds for short term as per their requirement.

Since, in Pass Through, all cash flow immediately in PTS in case of early retirement of receivables plus cash can be used for short term yield. This structure also provides the freedom to issue several debt trances with varying maturities.

(3) Stripped Securities

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

(i) Interest Only (IO) Securities

(ii) Principle Only (PO) Securities

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

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

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

Value of securities increases when interest rate goes up in the market as more interest is calculated on borrowings.

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

5.8 Evaluation of the outsourcing proposal

Guru Limited is exploring the options of outsourcing its administrative, finance, HR, and IT activities to a third party service provider to enable him to focus on the core activities.

Outsourcing is often an integral part of downsizing or reengineering and is considered to reduce costs or improve efficiency by shifting tasks, operations, jobs, or process to another party for a span of time. The outsourcing proposal of Guru Limited can be evaluated giving due consideration to the below pros and cons of outsourcing:

Advantages of Outsourcing

- Outsourcing helps in cost savings. The lower cost of operation and labour, and reduction in overhead costs makes it attractive to outsource.
- It frees an organization from investments in technology, infrastructure and people that make up the bulk of a back-end process capital expenditure.
- It gives businesses flexibility in staffing, manpower management, helps in cost savings.

Disadvantages of Outsourcing

- One of the biggest disadvantages is the risk of losing sensitive data and the loss of confidentiality.
- Control of operations and deliverables of activities outsourced.
- Inexperienced worker or improper process can lead to quality problems.