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FOR CA FINAL EXAM PREPARATION

CA Final 2022 Suggested Answers · Paper 6F Multidisciplinary Case Study (Old Scheme)

EXAM	YEAR	TYPE
CA Final	2022	Suggested Answers

SUBJECT	DATE
Paper 6F Multidisciplinary Case Study (Old Scheme)	May 2022

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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 four case study questions out of five.

All your workings should form part of your answer.

CASE STUDY – 1

Facts of the Case

PS Limited (PSL) is manufacturers for Electric circuits, boards and switchgear. Its products are sold to customers through retail network and its distributors are situated across the country. The company also exports these products but only to a few countries worldwide. The company is also engaged in taking projects on turn-key basis. The company has plants in Himachal Pradesh, Tamil Nadu, Maharashtra and Andhra Pradesh.

The company has a high reputation amongst its stakeholders viz. shareholders, workers and customers. The attrition rate of employees is also very low compared to other players in the market. The main reason for such low rate is because the company believes in 'family' concept of our country and treats the employees as part of the large family and has several schemes to keep their morale high. Employees are also part of decision making and they are also made to share profit of the company according to a well-defined profit-sharing plan. The terms of the profit sharing plan are as under:

(a) The profit sharing pool will be the least of the following three limits:

(i) 40% of earning before taxes, to the extent it is in excess of the minimum acceptable target profit margin;

(ii) 0.65% of gross revenue

(iii) absolute amount of ₹ 3.00 Crores

(b) Minimum acceptable target profit will be equivalent to the average of last three year's net operating profit of industry.

(c) The individual employee will be entitled to share profit in the pool in proportion to his salary to the total salary of all employees.

The information for the year 31st March, 2021 is as under:

1. *The earning before tax of PSL is ₹ 50 Crores.*
2. *Net Operating Assets employed by PSL is ₹ 130 Crores.*
3. *During the year, Gross revenue of PSL is ₹ 400 Crores.*
4. *Total Salary to employees during the year was ₹ 45 Crores.*

Industry's average net operating profit of last 3 years is 10% of net operating assets.

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During the year ended 31st March 2021, PSL (the company) ordered two aircrafts for convenience of visit by higher officials to its various plants for a total price of ₹ 5 Crores each, on 1st February 2021. These aircrafts will be delivered in September 2023. The company has made a down payment of 50% for each aircraft at the time of placing the order on 1st February 2021. The balance amount is payable on delivery. The advance paid by the company has fully been funded by bank borrowings taken on 1st February 2021. The company has paid interest of ₹ 3,00,000 during the financial year 2020-21. The manufacturer has informed that manufacture of each aircraft, including planning, production of parts and assembly, involves a typical time of 24 to 30 months. The manufacturer will start the manufacturing process for the aircraft from 30th September 2021.

The trade payables of the company consist of outstanding dues of various trade payables as follows - Micro enterprises (₹ 75 crore), Medium enterprises (₹ 50 crore), Small enterprises (₹ 55 crore) and others (₹ 65 crore). Further, out of above trade payables, ₹ 40 Crores are outstanding for more than 6 months as on balance sheet date.

The company PS Limited has taken on contract a turnkey project for ₹ 300 lakh. As per terms of the contract, the company will be entitled to get performance bonus @ 1% of the contract value and will be based on timing of the completion of the project. On the other hand, if the completion gets delayed, there is a penalty clause in the contract.

NBV Associates, Chartered Accountants are statutory auditors of PS Ltd. for the year ended 31st March, 2021. CA B.V. is conducting the audit as audit partner. While conducting audit for the year he came to know that a fraud amounting to ₹ 5 Crores being committed by one of the employees.

Provide the correct option to the following Questions

Multiple Choice Questions

1.1 Mr. R is one of the employees of PS Limited and is entitled to participate in profit sharing plan. What will be the amount of his share, if his annual salary is ₹ 54 lakh:

(a) ₹ 3.12 lakh

(b) ₹ 3.00 lakh

(c) ₹ 7.00 lakh

(d) ₹ 2.60 lakh

1.2 The Profit Sharing pool of PS Limited will be:

(a) ₹ 3.00 Crores

(b) ₹ 7.00 Crores

(c) ₹ 2.60 Crores

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(d) ₹ 2.00 Crores

1.3 The capitalisation of borrowing cost for purchase of aircraft should commence on:

(a) 1st February 2021.

(b) September 2023 when the aircrafts are delivered.

(c) 30th September 2021 when the manufacturing of aircraft is started.

(d) 1st April 2021.

1.4 What amount of trade payables shall be separately disclosed in the Balance Sheet as required by the amended Schedule III of the Company's Act 2013?

(a) ₹ 40 crore (Outstanding for more than 6 months).

(b) ₹ 130 crore (Dues of Micro and Small Enterprises).

(c) ₹ 180 crore (Dues of Micro, Small and Medium Enterprises).

(d) No separate disclosure is required.

1.5 NBV Associates should report the fraud to/in:

(a) Audit Committee/ Board of Directors of PS Limited and in Auditor's Report.

(b) Shareholders of PS Ltd and no further reporting.

(c) In Auditor's Report only.

(d) Central Government and in Auditor's Report. **(2 x 5 = 10 Marks)**

Descriptive Questions

1.6 Explain profit sharing plan, as performance management tool and group incentive plan. **(3 Marks)**

1.7 Define qualifying asset for capitalising the borrowing cost and explain when the capitalisation should commence and cease. **(5 Marks)**

1.8 Explain "Variable Consideration" and how it will be accounted for in terms of Ind AS. **(7 Marks)**

ANSWER TO CASE STUDY 1

PART – A

1.1 (a)

1.2 (c)

1.3 (c)

1.4 (b)

1.5 (d)

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PART – B

1.6 Profit Sharing Plan

Profit Sharing is a group incentive arrangement where cash bonus is paid to worker or employees, calculated based upon the reported profit of concerned division (responsibility centre) of entity or of entity as a whole. Since profit sharing is based upon the profit, hence can be said a compensation plan based upon short – term performance.

Profit share plan must define the percentage of profit to be shared and who are eligible employees for participation and what will the ratio of participation by each employee/worker in the bonus pool and formula for computing each of these percentage or ratio. The criteria for participation in share may be score or salary/wage.

Profit share plan may be used to boost the motivation among the employees to enhance and promote their performance hence profit-sharing plan can be considered as performance management tool. Profit sharing plan can also be considered as pre-stage of Kaizen Costing.

1.7 Qualifying asset:

A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. (Para 5 of Ind AS 23). Financial assets, and inventories that are manufactured, or otherwise produced over a short period of time, are not qualifying assets. Assets that are ready for the intended use for sale when acquired are not qualifying asset.

Though substantial period has not been defined in Ind AS 23, still in general it is considered as 1 year or more or as deemed fit by the entity.

In the given case, aircrafts are qualifying assets as it takes substantial period of time (i.e. 24 to 30 months) to get ready for intended use.

Commencement of capitalisation:

As per paragraph 17 of Ind AS 23, an entity shall begin capitalising borrowing costs as part of the cost of a qualifying asset on the commencement date. The commencement date for capitalisation is the date when the entity first meets **all** of the following conditions:

(a) It incurs expenditures for the asset.

(b) It incurs borrowing costs.

(c) It undertakes activities that are necessary to prepare the asset for its intended use or sale.

Activities necessary to prepare the asset for its intended use or sale includes technical or administrative work prior to the commencement of physical construction such as the activities associated with obtaining permits prior to starting of physical construction.

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However, such activities exclude the holding of an asset when no production or development that changes the asset's condition is taking place.

In the given case, Capitalisation of borrowing cost for purchase of aircrafts should commence on 30th September, 2021, since on this date all aforementioned conditions are satisfied. Hence 30th September, 2021 is the commencement date for capitalisation of borrowing costs and accordingly capitalisation of borrowing cost will commence from 30th September, 2021.

Cessation of capitalisation:

As per para 22 of Ind AS 23, an entity shall cease capitalising borrowing costs when **substantially all the activities** necessary to prepare the qualifying asset for its intended use or sale **are complete**. Sometimes physical construction is complete but routine admin work might continue like decoration, furnishing etc.

Further, as per para 24 of Ind AS 23, when an entity completes the construction of a qualifying asset in parts and each part is capable of being used while construction continues on other parts, the entity shall cease capitalising borrowing costs when it completes substantially all the activities necessary to prepare that part for its intended use or sale. If one part is dependent on the other then continue capitalisation of borrowing cost unless the entire asset is substantially completed.

1.8 Definition of variable consideration

If the consideration promised in a contract includes a variable amount, an entity shall estimate the amount of consideration to which the entity will be entitled in exchange for transferring the promised goods or services to a customer. (Para 50 of Ind AS 115)

An amount of consideration can vary because of discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, or other similar items. The promised consideration can also vary if an entity's entitlement to the consideration is contingent on the occurrence or non-occurrence of a future event. For example, an amount of consideration would be variable if either a product was sold with a right of return, or a fixed amount is promised as a performance bonus on achievement of a specified milestone. (Para 51 of Ind AS 115)

In some contracts, penalties are specified. In such cases, penalties shall be accounted for as per the substance of the contract. Where the penalty is inherent in determination of transaction price, it shall form part of variable consideration. (Para 51AA of Ind AS 115)

Accounting for variable consideration

Further, para 53 of Ind AS 115 states that an entity shall estimate an amount of variable consideration by using either of the following methods, depending on which method the entity expects to better predict the amount of consideration to which it will be entitled:

(a) The expected value — the expected value is the sum of probability-weighted amounts in a range of possible consideration amounts. An expected value may be

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an appropriate estimate of the amount of variable consideration if an entity has a large number of contracts with similar characteristics.

(b) The most likely amount — the most likely amount is the single most likely amount in a range of possible consideration amounts (ie the single most likely outcome of the contract). The most likely amount may be an appropriate estimate of the amount of variable consideration if the contract has only two possible outcomes (for example, an entity either achieves a performance bonus or does not).

An entity is required to choose between the expected value method and the most likely amount method. The choice is based on the method which better predicts the amount of consideration to be entitled. That is, the method selected is not meant to be a free choice. Rather, an entity selects a method that is best suited, based on the specific facts and circumstances of the contract.

In accordance with the above, in this case, PS Limited should recognise the amount of revenue only to the extent of ₹ 300 lakh assuming all the conditions of revenue recognition are met. In this case, the balance amount of performance bonus (as addition to revenue) or penalty (as deduction from revenue) which is linked to future event should be recognised after the completion of the project.

CASE STUDY - 2

Facts of the Case:

TP Limited is a company which deals in various commodities. Previous year the company achieved a turnover of ₹1000 Crores. The paid up equity capital of the company is ₹15 Crores. The Company is a listed public company. The company has its offices in Mumbai, Kolkata, Chennai and Delhi. The Company trades in Commodity "X" which is mainly dealt at Mumbai Market. However, the company also obtains the information from Kolkata Market regarding this product. The company has gathered the following information/data in this regard:

	Market Mumbai	***Market Kolkata***
Volume (annual, in millions ₹)	*30*	*120*
Transactions (per day)	*25*	*65*
Price (at period end, ₹)	*110*	*107*
Transport costs (₹)	*(8)*	*(4)*
Potential fair value (₹)	*102*	*103*
Transaction costs (₹)	*(3)*	*(5)*
Net proceeds (₹)	*99*	*98*

M/s YM Associates, Chartered Accountants are Auditors of the Company. The company has an Audit Committee and a Risk Management Committee in place. Both the committees met twice

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during the year. Further, in one of the meetings of Audit Committee conducted during the FY 2020-21, the internal control system and auditor's report of TP Ltd. were discussed. Mr. Yasvardhan, audit partner was also present at one of the meeting and the Audit Committee called for the comments of Mr. Yasvardhan if any. Certain important decisions regarding the changes in the internal control system were duly taken by majority voting.

The Company is having Mr Tara Prasad as its Managing Director and Ms. Julie as Company Secretary. The Company has appointed CA. Vinod as CFO who is also CFO in another unlisted company. Ms. Julie resigned from Company Secretary's post on 1st January 2021.

MX Limited is an associate of TP Limited. NCLT has passed an order for conducting meeting of the members for considering the scheme of compromise and arrangement, the necessity of which has arisen on account of certain disputes with the creditors of the company. Company has sent notice of the meeting to all its 1000 members holding total 30 lakh shares. On the date of meeting, only 580 members holding 18 lakh shares attended the meeting and 400 members holding 14 lakh shares voted in favour of the scheme of compromise and arrangement and remaining voted against the scheme.

Provide the correct option to the following Questions

Multiple Choice Questions

2.1 Is the company justified in holding meeting of its Audit Committee and Risk Management Committee twice in the F.Y. 2020-21?

(a) Yes, the company is justified as the meetings of both the committees were held as per the company's requirement and the important matters were duly discussed and conducting a meeting involves expense and when all the matters were discussed in two meetings it is wise on the part of the company that they did not hold more meetings.

(b) No, the company is not justified in holding two meetings of both the committees as the Audit Committee should meet at least four times in a year and Risk management committee can meet once in a year.

(c) The company is not justified in holding two meetings of the Audit Committee as an audit committee should meet at least four times in a year; however, the company can hold two meetings of Risk management committee.

(d) The company is justified as it is at the discretion of the Board of Directors to hold the meetings of the various committees of the company as per the company's requirement to discuss the matters.

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2.2 With respect to the meeting of Audit Committee attended by Mr. Yasvardhan, what all rights can be exercised by Mr. Yasvardhan?

(a) Mr. Yasvardhan has right to be heard and to vote in the meeting of Audit Committee of TP Ltd when it considers the auditor's report.

(b) Mr. Yasvardhan has right to vote in the meeting of Audit Committee of TP Ltd when it considers the auditor's report.

(c) Mr. Yasvardhan, being statutory auditor does not have right to be heard and to vote in the meeting of Audit Committee of TP Ltd even if it considers the auditor's report. Such rights vest with the internal auditors of the company.

(d) Mr. Yasvardhan has right to be heard in the meeting of Audit Committee of TP Ltd when it considers the auditor's report but shall not have right to vote.

2.3 The fair Value of Commodity "X" will be

(a) ₹ 102

(b) ₹ 103

(c) ₹ 99

(d) ₹ 98

2.4. TP Limited has violated the provisions of the Companies Act, 2013 by appointing CA. Vinod as its CFO:

(a) There is no violation of law as whole-time key management personnel can hold office in more than one company even if it is not its Subsidiary company.

(b) Yes, there is violation of company law as whole-time key managerial personnel shall not hold office in more than one company except in its subsidiary company at the same time.

(c) The appointment of CFO is not a mandatory requirement; hence, appointment of CFO who is also CFO in other company does not violate the provisions of law.

(d) There are 2 other whole-time key management personnel and therefore, if one person is holding office in other company, does not violate the provision of law.

2.5. The vacancy created by resignation of Ms. Julie shall be filled:

(a) By the board at a meeting of the board within 6 months from the date of such vacancy.

(b) By the Managing director within 6 months from the date of such vacancy.

(c) By the shareholders in its meeting within 6 months from the date of such vacancy.

(d) At will of the board of directors, there is no time limit to fill the vacancy.

(2 x 5 = 10 Marks)

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Descriptive Questions

2.6. Explain the constitution of Audit Committee as per the provisions of the Companies Act, 2013 and SEBI (LODR) Regulations 2015. ***(4 Marks)***

2.7. Explain the term 'Fair Value' in terms of Ind AS. Also define the term 'Principal Market' and how it is determined. ***(3 Marks)***

2.8. In terms of case study given, explain whether the scheme got proper approval of the members or not. Also explain the procedure for compromise or arrangements with creditors or members as per the provisions of the Companies Act 2013. ***(8 Marks)***

ANSWER TO CASE STUDY 2

PART – A

2.1 (c)

2.2 (d)

2.3 (b)

2.4 (b)

2.5 (a)

PART – B

2.6 Constitution of Audit Committee :

I. Audit Committee under Section 177 of the Companies Act, 2013 : (i) As per section 177 read with Rule 6 of the Companies (Meetings of Board and its Powers) Rules, 2014, every listed public company and the following classes of companies shall constitute an Audit Committee –

(a) all public companies with a paid-up capital of ten crore rupees or more;

(b) all public companies having turnover of one hundred crore rupees or more;

(c) all public companies, having in aggregate, outstanding loans, debentures and deposits, exceeding fifty crore rupees.

However, following class of unlisted public companies shall not be covered:

(1) a joint venture;

(2) wholly owned subsidiary; and

(3) a dormant company as covered u/s 455.

Explanation- The paid-up share capital or turnover or outstanding loans, debentures and deposits, as the case may be, as existing on the date of last audited Financial Statements shall be taken into account for the purposes of this rule.

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Section 139(11) provides that where a company is required to constitute an Audit Committee under section 177, all appointments, including the filling of a casual vacancy of an auditor under this section shall be made after taking into account the recommendations of such committee.

(ii) The Audit Committee shall consist of a minimum of three directors with independent directors forming a majority. It may be noted that majority of members of Audit Committee including its Chairperson shall be persons with ability to read and understand, the financial statement.

II. Audit Committee Under LODR Regulations: Every listed entity shall constitute a qualified and independent audit committee in accordance with the terms of reference, subject to the following:

1. The Audit Committee shall have minimum three directors as members. Two-thirds of the members of audit committee shall be independent directors, however, in case of a listed entity having outstanding SR (Superior Rights) equity shares, the audit committee shall only comprise of independent directors.
2. All members of Audit Committee shall be financially literate and at least one member shall have accounting or related financial management expertise.

   Explanation (i): The term "financially literate" means the ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows.

   Explanation (ii): A member will be considered to have accounting or related financial management expertise if he or she possesses experience in finance or accounting, or requisite professional certification in accounting, or any other comparable experience or background which results in the individual's financial sophistication, including being or having been a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities.
3. The Chairperson of the Audit Committee shall be an independent director and he/she shall be present at Annual General Meeting to answer shareholder queries.
4. The Company Secretary shall act as the secretary to the committee.
5. The Audit Committee at its discretion shall invite the finance director or the head of the finance function, head of internal audit and a representative of the statutory auditor and any other such executives to be present at the meetings of the committee, provided that occasionally, the Audit Committee may meet without the presence of any executives of the listed entity.

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2.7 Definition of fair value

Ind AS 113 defines fair value as **the price** that would be received to sell an asset or paid to transfer a liability in **an orderly transaction** between **market participants** at the measurement date.

A fair value measurement is for a particular asset or a liability. Therefore, an entity shall take into account the characteristics of the asset or the liability, if market participants would take those characteristics into account when pricing the asset or liability at the measurement date.

Definition of principal market

Principal market is the market which is normally the place in which the assets / liabilities are being transacted with highest volume and with high level of activities comparing with any other market available for similar transactions. If there is principal market, the price in the market must be used even if the prices in the other market are more advantageous.

Determination of fair value in principal market

The transaction costs are not a characteristic of an asset or a liability, but a characteristic of the transaction. Hence, it would not be appropriate to consider any transaction cost further while assessing fair values from such principal markets. It is the cost that would be incurred to transport the asset from its current location to its principal (or most advantageous) market. Hence, transport cost would be considered, if in case it is an inherent part of the Assets/ Liability so transacted e.g. commodity.

2.8 As per section 230 (6) of the Companies Act, 2013 where majority of persons at a meeting held **representing 3/4th in value,** voting in person or by proxy or by postal ballot, agree to any compromise or arrangement and if such compromise or arrangement is sanctioned by the Tribunal by an order. The majority of person representing 3/4th Value shall be counted of the following:

- the creditors, or
- class of creditors or
- members or
- class of members, as the case may be,

The majority is dual, in number and in value. A simple majority of those voting is sufficient. Whereas the 'three-fourth' requirement relates to value. The three-fourth value is to be computed with reference to paid-up capital held by members present and voting at the meeting.

In this case out of 1,000 members (holding 30 lakh shares), 580 members attended the meeting. As 400 members voted in favour of the scheme the requirement relating to majority in number (i.e. 291) is satisfied. 580 members who participated in the meeting held 18,00,000 shares, three-fourth of which works out to 13,50,000 and 400 members

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who voted for the scheme held 14,00,000 shares. As both the requirements are fulfilled, the scheme is approved by the requisite majority.

Section 230 of Companies Act, 2013 deal with the basic procedures to be followed for any compromise and arrangement, meetings of creditors, members and security holders for approval and powers of NCLT. According to this section:

(1) **Power of Tribunal to call for a meeting on an application filed for a compromise/arrangement [Sub-section 1)]:** Where a compromise or arrangement is proposed between—

(a) **a company and its creditors** or any class of them; or

(b) **a company and its members** or any class of them,

the Tribunal may, on the application of the company or of any creditor or member of the company, or in the case of a company which is being wound up, of the liquidator, appointed under this Act or under the Insolvency and bankruptcy Code, 2016, as the case may be, order a meeting of the creditors or class of creditors, or of the members or class of members, as the case may be, to be **called, held and conducted** in such manner as the Tribunal directs.

(2) **Disclosures by applicant [Sub-section (2)]:** The Company or any other person, by whom an application is made, shall disclose to the Tribunal by affidavit—

(a) **all material facts** relating to the company, such as the latest financial position of the company, the latest auditor's report on the accounts of the company and the pendency of any investigation or proceedings against the company;

(b) **reduction of share capital** of the company, if any, included in the compromise or arrangement;

(c) **any scheme of corporate debt restructuring** consented to by not less than seventy-five percent of the secured creditors in value, including—

(i) a creditor's responsibility statement in the prescribed form;

(ii) safeguards for the protection of other secured and unsecured creditors;

(iii) report by the auditor that the fund requirements of the company after the corporate debt restructuring as approved shall conform to the liquidity test based upon the estimates provided to them by the Board;

(iv) where the company proposes to adopt the corporate debt restructuring guidelines specified by the Reserve Bank of India, a statement to that effect; and

(v) a valuation report in respect of the shares and the property and all assets, tangible and intangible, movable and immovable, of the company by a registered valuer.

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(3) **Notice of meeting conducted on order of Tribunal [Sub-section (3)]:** Where a meeting is proposed to be called in pursuance of an order of the Tribunal, a notice of such meeting shall be sent to-

- all the creditors or class of creditors, and
- to all the members or class of members,
- and the debenture-holders of the company,
- Sectoral regulators u/s 230(5)

individually at the address registered with the company.

Annexure with Notice: Notice of meeting shall be accompanied by a statement disclosing the following:

- details of the compromise or arrangement,
- a copy of the valuation report, if any, and
- explaining their effect on creditors, key managerial personnel, promoters and non-promoter members, and the debenture-holders and
- the effect of the compromise or arrangement on any material interests of the directors of the company or the debenture trustees, and
- such other matters as may be as prescribed under Rule 6 of the Companies (Compromises, arrangements and amalgamations) Rules, 2016.

Advertisement of notice: Such notice and other documents shall also be placed on:

- the website of the company, if any, and
- in case of a listed company, these documents shall be sent to the Securities and Exchange Board and stock exchange where the securities of the companies are listed, for placing on their website and
- shall also be published in newspapers in such manner as prescribed under Rule 7 of the Companies (Compromises, arrangements and amalgamations) Rules, 2016.

Time period for the receipt of the copies of the compromise or arrangement: Where the notice for the meeting is also issued by way of an advertisement, it shall indicate the time within which copies of the compromise or arrangement shall be made available to the concerned persons free of charge from the registered office of the company.

(4) **Notices to sectoral regulators to make representation, if likely to be affected by the compromise or arrangement [Sub-section (5)]:** A notice along with all the

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documents in such form as may be prescribed shall also be sent to other sectoral regulators and shall require that representations, if any, to be made by them shall be made within a period of thirty days from the date of receipt of such notice, failing which, it shall be presumed that they have no representations to make on the proposals.

(5) **The Tribunal may dispense with calling of a meeting** of creditor or class of creditors where such creditors or class of creditors, having at least ninety per cent value, agree and confirm, by way of affidavit, to the scheme of compromise or arrangement. [Sub-section (9)]

(6) **Vote to the adoption of the compromise or arrangement [Sub-section (4)]:** A notice shall provide that the persons **to whom the notice is sent may vote** in the meeting either themselves or through proxies or by postal ballot to the adoption of the compromise or arrangement within **one month** from the date of receipt of such notice:

Provided that any objection to the compromise or arrangement shall be made only by persons holding not less than ten per cent of the shareholding or having outstanding debt amounting to not less than five per cent of the total outstanding debt as per the latest audited financial statement.

(7) **Binding order of Tribunal[Sub-section (6)]:** Where, at a meeting held, majority of persons representing **three-fourths in value** of the creditors, or class of creditors or members or class of members, as the case may be, voting in person or by proxy or by postal ballot, **agree to any compromise or arrangement** and if such compromise or arrangement is **sanctioned by the Tribunal** by an order, the same **shall be binding** on the company, all the creditors, or class of creditors or members or class of members, as the case may be, or, in case of a company being wound up, on the liquidator, "appointed under this Act or under the Insolvency and Bankruptcy Code, 2016, as the case may be," and the contributories of the company.

(8) **Particulars to be stated in the order [Sub-section (7)]:** An order made by the Tribunal, shall provide for all or any of the following matters, namely:—

(a) **where the compromise or arrangement provides for conversion of preference shares into equity shares**, such preference shareholders shall be given an option to either obtain arrears of dividend in cash or accept equity shares equal to the value of the dividend payable;

(b) the **protection of any class** of creditors;

(c) if the compromise or arrangement results in the **variation of the shareholders' rights**, it shall be given effect to under the provisions of section 48;

(d) if **the compromise or arrangement is agreed to by the creditors** under sub-section (6), any proceedings pending before the Board for Industrial and

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Financial Reconstruction (BIFR) established under section 4 of the Sick Industrial Companies (Special Provisions) Act, 1985 shall abate;

(e) **such other matters** including exit offer to dissenting shareholders, if any, as are in the opinion of the Tribunal necessary to effectively implement the terms of the compromise or arrangement:

Provided that no compromise or arrangement shall be sanctioned by the Tribunal unless a certificate by the company's auditor has been filed with the Tribunal to the effect that the accounting treatment, if any, proposed in the scheme of compromise or arrangement is in conformity with the accounting standards prescribed under section 133.

(9) **Filing of order of tribunal with registrar [Sub-section (8)]:** The order of the Tribunal shall be filed with the Registrar by the company **within** a period of **thirty days** of the receipt of the order.

(10) **Exemption in relation to buy-back of securities [sub-section (10)]:** No compromise or arrangement in respect of any buy-back of securities under this section shall be sanctioned by the Tribunal unless such buy-back is in accordance with the provisions of section 68.

(11) **Inclusion of takeover offer [Sub-section (11)]:** Any compromise or arrangement may include **takeover offer** made in such manner as may be prescribed.

Provided that in case of listed companies, takeover offer shall be as per the regulations framed by the Securities and Exchange Board.

(12) **Application to tribunal by aggrieved party [Sub-section (12)]:** An aggrieved party may make an **application to the Tribunal** in the event of any grievances with respect to the **takeover offer of companies other than listed companies** in such manner as may be prescribed and the Tribunal may, on application, pass such order as it may deem fit**.**

Explanation— For the removal of doubts, it is hereby declared that the provisions of section 66 (reduction of share capital) shall not apply to the reduction of share capital effected in pursuance of the order of the Tribunal under this section.

Since reduction of share capital requires an application to Tribunal by company after passing Special Resolution and on confirmation by Tribunal, reduction of share capital gets effected. However, in the case of compromise under section 230 if that results into reduction of capital, compliance of section 66 is not required to be made separately in such cases.

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CASE STUDY-3

Facts of the Case:

BMY LLP, a firm of Chartered Accountants has various divisions/verticals. Each division is headed by a Chartered Accountant who is qualified and has done specialised course. Each head is known for his knowledge and integrity amongst professionals and in Industry. BMY is also known as financial analyst as well as consultant for mergers and acquisitions. The firm has been approached by its clients to render professional advice on several issues highlighted in the under mentioned case scenarios:

CASE SCENARIO - 1

Tame Limited is a company engaged in telecommunication services and presently its major presence is in North India. The company wants to expand its business in South. The company has got two options. One is to expand itself by opening its own network which will take substantial time and efforts and results will also be not fast. On the other hand, the company may target to acquire an existing telecom company having sufficient customer base in South and to integrate its North India operation with the acquired company. It will yield quick results.

The company is willing to appoint the firm to identify and to take the process of acquisition forward. After study the M&A vertical of the firm has identified a company M/s Pool Limited which has got presence in South but is not doing too well. The information of both the companies is given below:

	Tame Ltd.	Pool Ltd.
Total Earnings (E) (in lakh)	₹ 1200	₹ 400
Number of outstanding shares (S) (in lakh)	400	200
Price earnings ratio (PIE)	8	7

The PIE ratio of the combined entity is expected to be 10?

CASE SCENARIO - 2

Ms. Devina is fond of making cakes, pickles, papad and other eatables homemade and her friends persuaded her to take it as a venture. Before starting it as a venture, she wants to try it whether she should turn her hobby into a regular business or not. She lives in New Delhi. To start with, she promoted her products through her social media friends and started getting orders from nearby places like Noida (Uttar Pradesh), Faridabad (Haryana); Gurugram (Haryana). All these places fall within 'National Capital Region (NCR). She expects to have monthly turnover of ₹ 10,000.

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CASE SCENARIO - 3

M/s GAAR Limited enters into a 3 years lease of an immovable property with M/s GAP Limited for annual lease rental of ₹60,000 per annum. There is extension clause in the agreement which provides that lease may be extended to 5 years and in the present circumstances, it is most likely that the lease term will be extended. In case of extended period, the lease rent will be increased by 10%. Lessee's incremental rate of borrowing is 9%. M/s GAAR Limited has given residual guarantee to M/s GAP Limited of ₹50,000. If the lessee terminates the contract at any time before 3 years, the Jessee will be required to pay ₹30000 as penalty to the lessor. PV Ratio of 5 years at 9% are as 0.917,0.842, 0.772,0.708, 0.650 respectively.

CASE SCENARIO - 4

Mr. B one of the partners of the firm is facing a dilemma as to whether the firm BMY LLP should accept the appointment as Statutory Auditors of M/s Foam Limited wherein Mr. B had sent a communication in writing addressed to the outgoing auditor Mr. Dalai under certificate of posting and the outgoing auditor has sent an acknowledgement vide their official email, but this email address of the outgoing auditor is not registered with the Institute of Chartered Accountants of India. Mr. B is of the opinion that this is not a positive evidence of delivery and violates the code of ethics, if the firm accepts the audit assignment.

CASE SCENARIO - 5

An investor has got investment in 3 stocks and is willing to know the beta of his portfolio. The following information in respect of these 3 stocks is given below:

Security	*No. of Shares*	*Market Price*	*β*
SVL	*15000*	*60*	*0.90*
SCL	*8000*	*35*	*1.00*
MLS	*7500*	*30*	*1.50*

Provide the correct option to the following Questions

Multiple Choice Questions

3.1 The exchange ratio acceptable to M/s Pool Limited in case scenario - 1 will be:

(a) 0.42:1

(b) 0.50:1

(c) 0.35:1

(d) 0.65:1

3.2 Will Ms. Devina in case scenario - 2 be required to take registration under GST Act, 2017 and whether she will be entitled to avail the composition levy scheme under the said Act:

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(a) *She will not be required to take registration as her turnover is less than the basic limit fixed for registration.*

(b) *She will be required to take registration as Composition supplier and will be eligible to take benefit of composition levy scheme.*

(c) *As her sales are inter-state, she will be required to take registration but can take benefit of composition levy scheme.*

(d) *She will be required to take registration and will not be entitled to take benefit of composition levy scheme as her sales are inter-state and when there is inter-state sale, there is neither basic exemption nor composition levy can be availed except for notified supplies.*

3.3 *What shall be the amount of lease liability and the finance cost for first year of M/s GAAR Limited under case scenario - 3:*

(a) *Lease Liability ₹2,41,488 and Finance Cost ₹21,733*

(b) *Lease Liability ₹3,62,000 and Finance Cost ₹32,580*

(c) *Lease Liability ₹2,73,988 and Finance Cost ₹24,659*

(d) *Lease Liability ₹3,03,988 and Finance Cost ₹27,359*

3.4 *With respect to the dilemma being faced by Mr. B partner of the firm in case scenario-4 regarding acknowledgment of the communication from the retiring auditor's vide their official email is not a positive evidence of delivery?*

(a) *The dilemma of Mr. B is correct as it is not a positive evidence of delivery.*

(b) *The dilemma of Mr. B is not correct as it is a positive evidence of delivery as the same is received from the official email of the outgoing auditor, as per the code of ethics.*

(c) *The dilemma of Mr. B is not correct as statutory auditors are not required to communicate with the retiring or outgoing auditors in this case.*

(d) *The dilemma of Mr. B is correct as the email address of the outgoing auditor vide which acknowledgement has come is not registered with the Institute of Chartered Accountants of India.*

3.5 *What would be the portfolio beta in case scenario - 5 above?*

(a) *1.133*

(b) *1.016*

(c) *1.074*

(d) *1.213* ***(2 x 5 = 10 Marks)***

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Descriptive Questions

3.6 Explain about the professional misconduct as defined in Part I of the First Schedule to the Chartered Accountants Act regarding accepting a position as an auditor previously held by another chartered accountant without first communicating with him in writing. ***(4 Marks)***

3.7 Define 'Lease' as per Ind AS and explain its various components. ***(4 Marks)***

3.8 Explain the circumstances when a supplier is required to seek registration under the Goods and Services Tax Act 2017 and can avail the benefit of Composition Scheme. ***(7 Marks)***

ANSWER TO CASE STUDY 3

PART – A

3.1 (a)

3.2 (d)

3.3 (c)

3.4 (b)

3.5 (b)

PART – B

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

It must be pointed out that professional courtesy alone is not the major reason for requiring a member to communicate with the existing accountant who is a member of the Institute or a certified auditor. The underlying objective is that the member may have an opportunity to know the reasons for the change in order to be able to safeguard his own interest, the legitimate interest of the public and the independence of the existing accountant. It is not intended, in any way, to prevent or obstruct the change. When making the inquiry from the retiring auditor, the one proposed to be appointed or already appointed should primarily find out whether there are any professional or other reasons why he should not accept the appointment.

It is important to remember that every client has an inherent right to choose his accountant also that he may, subject to compliance, with the statutory requirements in the case of limited companies, make a change whenever he chooses, whether or not the reasons which had impelled him to do so are good and valid. The change normally occurs where there has been a change of venue of business and a local accountant is preferred or where the partner who has been dealing with the client's affairs retires or dies; or where

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temperaments clash or the client has some good reasons to feel dissatisfied. In such cases, the retiring auditor should always accept the situation with good grace.

The existence of a dispute as regards the fees may be root cause of an auditor being changed. This would not constitute valid professional reasons on account of which an audit should not be accepted by the member to whom it is offered. However, in the case of an undisputed audit fees for carrying out the statutory audit under the Companies Act, 2013 or various other statutes having not been paid, the incoming auditor should not accept the appointment unless such fees are paid. In respect of other dues, the incoming auditor should in appropriate circumstances use his influence in favour of his predecessor to have the dispute as regards the fees settled. The professional reasons for not accepting an audit would be:

(a) Non-compliance of the provisions of Sections 139 and 140 of the Companies Act, 2013 as mentioned in Clause (9) of the Part - I of First Schedule to The Chartered Accountants Act, 1949; and

(b) Non-payment of undisputed Audit Fees by auditees other than in case of Sick Units for carrying out the Statutory Audit under the Companies Act, 2013 or various other statutes; and

(c) Issuance of a qualified report.

In the first two cases, an auditor who accepts the audit would be guilty of professional misconduct. As per Council General Guidelines, 2008 the *provision for audit fee in accounts signed by both the auditee and the auditor along with other expenses, if any, incurred by the auditor in connection with the audit*, *shall* be considered as *"undisputed audit fee"* and *"sick unit"* shall mean *a unit registered for not less than five years, which has at the end of any financial year accumulated losses equal to or exceeding its entire net worth.*

In the last case, however, he may accept the audit if he is satisfied that the attitude of the retiring auditor was not proper and justified. If, on the other hand, he feels that the retiring auditor had qualified the report for good and valid reasons, he should refuse to accept the audit. There is no rule, written or unwritten, which would prevent an auditor from accepting the appointment offered to him in these circumstances. However, before accepting the audit, he should ascertain the full facts of the case. For nothing will bring the profession to disrepute so much as the knowledge amongst the public that if an auditor is found to be "inconvenient" by the client, he could readily be replaced by another who would not displease the client and this point cannot be too over-emphasised.

Sometimes, the retiring auditor fails without justifiable cause except a feeling of hurt because of the change, to respond to the communication of the incoming auditor. So that it may not create a deadlock, the auditor appointed can act, after waiting for a reasonable time for a reply.

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Members should therefore communicate with a retiring auditor in such a manner as to retain in their hands positive evidence of the delivery of the communication to the addressee. In the opinion of the Council, the following would in the normal course provide such evidence:-

(a) Communication by a letter sent through "Registered Acknowledgement due", or

(b) By hand against a written acknowledgement, or

(c) Acknowledgement of the communication from retiring auditor's vide email address registered with the Institute or his last known official email address, or

(d) Unique Identification Number (UDIN) generated on UDIN portal (subject to separate guidelines to be issued by the Council in this regard)

3.7 Definition of lease

A lease is defined as a contract, or part of a contract that conveys the **right to control** the use of an **identified asset** for a **period of time** in **exchange for consideration**. An entity is required to assess at the inception of a contract, whether the contract is or contains a lease.

Various components of a lease

The component of a lease are:

(i) A contract

(ii) Identified Asset

(iii) Right to control the use

(iv) Period of time

(v) Consideration

(i) Contract: Contract may be oral or written.

(ii) Identified Asset: A contract contains a lease only if there is an identified asset.

An asset may be identified by being:

i. explicitly specified in a contract, or

ii. Implicitly specified at the time the asset it is made available for use by the customer

A customer does not have the right to use the identified assets if, at inception of contract, a supplier has the substantive rights to substitute throughout the period of use. A supplier's right to substitute an asset is SUBSTANTIVE when BOTH the following conditions are met:

i. The Supplier has the practical ability to substitute alternative assets throughout the period of use.

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ii. The supplier would benefit economically from the exercise of its right to substitute the asset.

An identified asset must be physically distinct. A physically distinct asset may be an entire asset or a portion of asset.

(iii) Right to Control:

i. For the purpose of assessing the right of use of unidentified asset, an entity shall see whether, throughout the period of use, the customer has both of the following:

1. right to obtain substantially all of the economic benefits from use of the identified asset and

2. right to direct the use of identified asset.

ii. If the customer has the right to control the use of an identified asset for only a portion of the term of the contract, the contract contains a lease for that of the term.

(iv) 'A period of time' may be described in terms of use of an identified asset (for example the number of production of units that an item of equipment will be used to produce). It includes any non-consecutive periods of time.

Lease term is a non-cancellable period for which a lessee has the right to use an underlying asset, beginning from the commencement date and includes any rent free periods provided by the lessor to the lessee, together with both:

i. periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option; and

ii. periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option.

(v) Consideration: Lease payments are defined as payments made by a lessee to a lessor relating to the right to use an underlying asset during the lease term, comprising the following:

- fixed payments (including in substance fixed payments), **less** any lease incentives
- variable lease payments that depend on an Index or a rate the exercise price of a purchase option if the lessee is reasonably certain to exercise that option
- payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.
- Residual value guarantees

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3.8 As per section 22 of the CGST Act, 2017, every supplier is liable to obtain registration in s State/Union Territory (other than Special Category States of Nagaland, Mizoram, Manipur, Tripura), from where he makes a taxable supply of goods and/or services, if his aggregate turnover in a financial year exceeds the threshold limit of ₹ 20 lakh.

Further, an enhanced threshold limit of ₹ 40 lakh is available as per Notification No. 10/2019 CT dated 07.03.2019 to a supplier engaged exclusively in the supply of goods in specified States. However, this enhanced threshold limit is not available to persons required to take compulsory registration under section 24 of the CGST Act, 2017. One of the specified categories of persons required to obtain registration compulsorily irrespective of the quantum of their aggregate turnover, under said section, is persons making inter-State taxable supply of goods.

In the given case, since Ms. Devina is engaged in the inter-State supply of goods, she is required to obtain registration compulsorily irrespective of her aggregate turnover.

While applying for registration, she also needs to examine whether she is eligible to avail the benefit of the composition scheme.

As per section 10 of the CGST Act, 2017, every registered person is eligible to avail the benefit of the composition scheme if his aggregate turnover, in other than specified Special Category States, in the preceding financial year does not exceed ₹ 1.5 crore, subject to fulfillment of specified conditions.

One of the conditions for availment of composition scheme for goods is that registered person should not be engaged in making any inter-State outward supplies of goods.

Therefore, even though the aggregate turnover of Ms. Devina does not exceed ₹ 1.5 crores in the preceding financial year, she is not eligible to avail the benefit of the composition scheme since she is engaged in making inter-State outward supplies of goods.

CASE STUDY - 4

Facts of the Case:

1. *A public limited company (hereinafter referred to as 'the company'), which is a wholly owned subsidiary of a listed company, is in the business of exploration and production of oil and gas and other hydrocarbon related activities outside India.*
2. *The company operates overseas projects directly and/or through subsidiaries, by participation in various joint arrangements and investment in associates. The company was following Accounting Standards as notified under the Companies (Accounting Standards) Rules, 2006 (ASs) until 31st March, 2016. However, in accordance with the Notification of Ministry of Corporate Affairs, the company has adopted Indian Accounting Standards (Ind ASs) with effect from 1st April, 2016;*
3. *Mineral rights are granted by the host governments in accordance with the applicable legal and fiscal regime in the host country which are incorporated into the binding contractual*

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arrangements entered into with the host governments. Mineral rights can be granted through direct license or through Production Sharing Agreement (PSA), under which the host government having ownership rights over the hydrocarbons, grants the rights to a company or consortium (usually called contractor) subject to certain obligations/ payments by the contractor including sharing of hydrocarbons, with the government or its nominated agency as per principles contained in PSA.

4. *The overseas oil and gas operations are generally conducted in joint arrangements with other partners. Main reason for holding mineral rights through jointly controlled entities/subsidiaries is because of host country's regulations and / or various business considerations (strategic/risk management/financing etc.). When the project is already in existence through a corporate structure and the company joins the project later on, the investment in jointly controlled entities/subsidiaries is a legacy issue.*
5. *Till the financial year 2014-15, the company has been preparing its consolidated financial statements for the group comprising of standalone financial statements of the company, its subsidiaries and jointly controlled entities in accordance with the applicable Accounting Standards (AS).*
6. *The company accounted for the investments in subsidiaries and jointly controlled entities in its standalone financial statements in accordance with the requirement of Accounting Standard (AS) 13, 'Accounting for Investments'. In consolidated financial statements of the company, the company was consolidating financial statements of its subsidiaries on a line by line basis following the consolidation procedures mentioned in paragraph 13 of Accounting Standard (AS) 21, 'Consolidated Financial Statements'. Similarly, in its consolidated financial statements, the company was reporting its interest in jointly controlled entities using proportionate consolidation as per the requirements of paragraphs 29 to 39 of Accounting Standard (AS) 27, 'Financial Reporting of Interests in Joint Ventures'.*
7. *Further, the company recognised goodwill in respect of subsidiaries and jointly controlled entities in accordance with the requirements of paragraph 13(b) of AS 21 and paragraph 36 of AS 27 respectively in its consolidated financial statements.*
8. *The company considered that such goodwill mainly arises due to corporate structure and the line by line consolidation of subsidiaries' I proportionate consolidation of jointly controlled entities' financial statements prepared on historical costs convention which do not take into consideration the valuation of underlying oil and gas reserves for which excess amount (i.e. goodwill calculated as per the relevant AS requirements) has been paid by the company at the time of acquisition.*
9. *The company further considered that in oil and gas E&P companies, the goodwill generated on acquisition of mineral rights either through jointly controlled entities or subsidiaries, inherently derives its value from the underlying mineral rights and, accordingly, value of such goodwill depletes as the underlying mineral resources are extracted.*

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10. *Therefore, taking a prudent approach and considering the above substance, the company framed the accounting policy for amortisation of the goodwill in respect of its subsidiaries/jointly controlled assets over the life of the underlying mineral rights using UOP method as under: "Goodwill Amortisation: The company amortises goodwill (on consolidation) based on 'Unit of Production Method' considering the related Proved Reserves."*

11. *This allowed the company to utilise the value of goodwill over the life of mineral rights and completely charging off the goodwill over the life of the reserves.*

12. *For financial year 2015-16, the company has stated that it had availed transition exemption under Ind AS 101, 'First-time Adoption of Indian Accounting Standards' and has not applied the principles of Ind AS 103, 'Business Combinations' retrospectively and, therefore, did not fair value the acquisition of shares in joint ventures (jointly controlled entities as per ASs) / subsidiaries which happened before the transition date of 1st April, 2015. Carrying amount of goodwill at the date of transition to Ind AS in accordance with applicable ASs has been taken as carrying value of the goodwill in the opening Ind AS Balance sheet.*

13. *According to the company, prospectively from the transition date, i.e., 1st April, 2015, acquisition of interest/share in subsidiary is to be accounted for in accordance with Ind AS 103 and acquisition of interest/share in joint venture/associate will be accounted for in accordance with Ind AS 28, 'Investments in Associates and Joint Ventures'.*

14. *The company understands that paragraph 32(a) of Ind AS 28 specifically prohibits amortisation of goodwill relating to an associate or a joint venture. It is noticed that there is no such specific prohibition laid down by Ind AS 103. It is also noticed that paragraph 10 (b) of Ind AS 36, Impairment of Assets requires testing of goodwill acquired in a business combination for impairment, annually.*

15. *Accordingly, as per the company, by simple reading of the applicable Ind ASs, it appears that Ind ASs envisage testing of goodwill annually for impairment rather than its amortisation. This seems to align with the concept of fair valuation of acquired assets and liabilities and goodwill/capital reserve being a residual amount. This however may not be the case where goodwill is carried at historical value in the manner as stated above. Accordingly, considering the substance over form of the goodwill to be in the nature of 'acquisition costs' (as discussed in paragraphs 8 to 13 above), the company intends to continue amortisation of the goodwill recognised under ASs in respect of its subsidiaries/ joint ventures (jointly controlled entities under ASs) over the life of the underlying mineral rights using Unit of Production method, under Ind ASs also post transition date in accordance with the same accounting policy as under: "Goodwill amortization: The company amortises goodwill (on consolidation) based on 'Unit of Production Method' considering the related proved reserves."*

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Provide the correct option to the following Questions

Multiple Choice Questions

4.1 As per Ind AS 110 which of the following parent entities are not exempted to present consolidated financial statement:

(a) If debt or equity instruments are not traded in a public market; it did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; and its ultimate or any intermediate parent produces financial statements that are available for public use and comply with Ind AS. Further its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements.

(b) An investment entity that is required to measure all of its subsidiaries at fair value through profit & loss account.

(c) Subsidiaries to which post-employment benefit plans or other long term employee benefit plans applies.

(d) The parent that controls one or more other associate companies.

4.2 On consolidated financial statements the Auditor issues:

(a) Independent Auditors Report on Consolidated Financial Statement.

(b) Companies (Auditor's Report) Order, 2020 on Consolidated Statement.

(c) Independent Auditors Report on Consolidated Financial Statement as well as Companies (Auditor's Report) Order, 2020 on Consolidated Statement.

(d) Neither Independent Auditors Report on Consolidated Financial Statement nor Companies (Auditor's Report) Order, 2020 on Consolidated Statement.

4.3 In the consolidated financial statements the financial statement of parent and group prepared as one entity with respect to:

(a) assets, liabilities and equity only.

(b) income and expenses only.

(c) income, expenses and cash flows only.

(d) assets, liabilities, equity, income, expenses and cash flows.

4.4 The due date of filing the FLA (Foreign Liabilities & Assets) annual return under FEMA, 1999 is:

(a) by 30th May of the close of the financial year.

(b) by 15th June of the close of the financial year.

(c) by 30th June of the close of the financial year.

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(d) by 15th July of the close of the financial year.

4.5 The general permission is not available to persons (individual) resident in India for purchase/acquisition of securities abroad when such purchase/acquisition is:

(a) out of the funds held in the RFC account.

(b) by way of bonus shares on existing foreign currency shares.

(c) by remitting up to the limit prescribed by the Reserve Bank from time to time, per financial year under the Liberalised Remittance Scheme (LRS).

(d) by remitting under LRS to set up special purpose vehicle for further investment.

(2 x 5 = 10 Marks)

Descriptive Questions

4.6 You have been asked to explain regarding appropriate accounting treatment under Ind AS for amortisation of the goodwill by the company and that whether the accounting treatment as suggested in paragraph 15 of the case study in respect of amortisation of goodwill by the company is appropriate? ***(7 Marks)***

4.7 What are the formalities under the Foreign Exchange Management Act, 1999 for setting up a jointly controlled entity abroad? ***(5 Marks)***

4.8 What is the process of acquiring of shares of an existing company abroad under the Foreign Exchange Management Act, 1999? ***(3 Marks)***

ANSWER TO CASE STUDY 4

PART – A

4.1 (d)

4.2 (a) or (b) or (c)

4.3 (d)

4.4 (d)

4.5 None of the options given is correct

PART – B

4.6 Point (g) of para C4 of Ind AS 101 states that the carrying amount of goodwill or capital reserve in the opening Ind AS Balance Sheet shall be its carrying amount in accordance with previous GAAP at the date of transition to Ind AS after the two adjustments. One of the adjustment states that the standard requires the first-time adopter to recognise an intangible asset that was subsumed in recognised goodwill or capital reserve in accordance with previous GAAP, the first-time adopter shall decrease the carrying amount of goodwill or increase the carrying amount of capital reserve accordingly (and, if applicable, adjust deferred tax and non-controlling interests)

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As per the facts given in para 8 of the case study the entity paid excess amount to avail the rights to use the underlying oil and gas reserves. However, since the rights was not recorded in the books at that time, the value of goodwill subsumed the value of that intangible asset which should now be separately identified in the books. Hence, value of goodwill will be reduced accordingly.

However, regardless of whether there is any indication that the goodwill may be impaired, the first-time adopter shall apply Ind AS 36 in testing the goodwill for impairment at the date of transition to Ind AS and in recognising any resulting impairment loss in retained earnings (or, if so required by Ind AS 36, in revaluation surplus). **The impairment test shall be based on conditions at the date of transition to Ind AS.** No other adjustments (eg- previous amortisation of goodwill) shall be made to the carrying amount of goodwill / capital reserve at the date of transition to Ind AS.

However, once goodwill is recognised in the opening transition date balance sheet, the entity has to follow the provisions of Ind AS, which states that goodwill is not amortised but rather tested for impairment annually.

Accordingly, the amortization of goodwill based on 'Unit of Production' method is not correct after implementing Ind AS.

4.7 Formalities under the Foreign Exchange Management Act, 1999, for setting up a jointly controlled entity abroad.

A resident individual may make overseas direct investment in the equity shares and compulsorily convertible preference shares of a Joint Venture (JV) or Wholly Owned Subsidiary (WOS) outside India. However, the limit of overseas direct investment by the resident individual is prescribed by RBI.

There are two routes though which investment can be made outside India:

Mode of direct investment outside India

(1) Automatic route for direct investment or financial commitment outside India

As per the Regulation 6 of the Foreign Exchange Management (Transfer or Issue of Any Foreign Security) (Amendment) Regulations, 2004, an **Indian Party has been permitted** to make investment/ undertake financial commitment in overseas Joint Ventures (JV)/ Wholly Owned Subsidiaries (WOS), as per the ceiling prescribed by the Reserve Bank.

With effect from July 03, 2014, it has been decided that any **financial commitment (FC) exceeding USD 1 (one) billion (or its equivalent) in a financial year** would require **prior approval** of the **Reserve Bank** even when the total FC of the Indian Party is within the eligible limit under the automatic route [i.e., within 400% of the net worth (Paid up capital + Free Reserves) as per the last audited balance sheet].

Requirements for investments/ financial commitments: The criteria for overseas direct investment under the Automatic Route is as under:

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i. The **Indian Party can invest up to the prescribed limit** of its net worth (as per the last audited Balance Sheet) in JV / WOS **for any bonafide activity** permitted as per the law of the host country. The prescribed limit vis-a-vis the net worth will not be applicable where the investment is made out of balances held in the EEFC account of the Indian party or out of funds raised through ADRs/GDRs;

ii. The **Indian Party is not on the Reserve Bank's exporters' caution list / list of defaulters** to the banking system published/ circulated by the Credit Information Bureau of India Ltd. (CIBIL) /RBI or any other credit information company as approved by the Reserve Bank or under investigation by the Directorate of Enforcement or any investigative agency or regulatory authority; and

iii. The **Indian Party routes all the transactions** relating to the investment in a JV/WOS through **only one branch of an authorised dealer** to be designated by the Indian Party.

Process: The Indian Party should approach an Authorized Dealer **with an application in Form ODI and the prescribed enclosures / documents** for effecting the remittances towards such investments.

Investments (or financial commitment) in JV/WOS abroad by Indian Parties through the **medium of a Special Purpose Vehicle (SPV)** are also permitted under the Automatic Route if the Indian Party is not appearing in the Reserve Bank's caution list or is under investigation by the Directorate of Enforcement or included in the list of defaulters to the banking system circulated by the Reserve Bank/any other Credit Information company as approved by the Reserve Bank.

(2) Approval route for direct investment or financial commitment outside India

(i) **Prior approval of the Reserve Bank** would be required in all other cases of direct investment (or financial commitment) abroad.

(ii) Reserve Bank would, inter alia, take into account the **following factors** while considering such applications:

(a) **Prima facie viability** of the JV / WOS outside India;

(b) **Contribution to external trade and other benefits** which will accrue to India through such investment (or financial commitment);

(c) **Financial position and business track record** of the Indian Party and the foreign entity; and

(d) **Expertise and experience of the Indian Party in the same or related line of activity** as of the JV / WOS outside India.

Therefore, under the approval route (proposals not covered by the conditions under the automatic route) prior approval of the Reserve Bank would be

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required. For which a specific application in Form ODI with the documents prescribed therein is required to be made through the Authorized Dealer Category – I banks.

With effect from August 05, 2013, a **resident individual** (single or in association with another resident individual or with an 'Indian Party' as defined in the Notification) satisfying the criteria as per Schedule V of the Notification, **may make overseas direct investment** in the equity shares and compulsorily convertible preference shares of a Joint Venture (JV) or Wholly Owned Subsidiary (WOS) outside India. The limit of overseas direct investment by the resident individual shall be within the overall limit prescribed by the Reserve Bank of India under the provisions of Liberalised Remittance Scheme, as prescribed by the Reserve Bank from time to time.

4.8 The following is the process for acquiring of shares of an existing company aboard under the Foreign Exchange Management Act, 1999:

1. Schedule I of Regulation 3(1)(A) of Foreign Exchange Management (permissible Capital Account Transactions) Regulations, 2000 allows investment by a person resident in India in foreign securities.

   Thus, a person resident in India is eligible to invest in the foreign securities.

2. As per Regulation of 4 of the Foreign Exchange Management (Permissible capital account transactions) Regulations, 2000, an amount of USD 2,50,000 per financial year can be utilized for making permissible capital account transactions.

3. As per the Regulation 6 of the Foreign Exchange Management (Transfer or Issue of Any Foreign Security) (Amendment) Regulations, 2004, an Indian Party has been permitted to make investment/ undertake financial commitment in overseas Joint Ventures (JV)/ Wholly Owned Subsidiaries (WOS), as per the ceiling prescribed by the Reserve Bank.

According to that any financial commitment (FC) exceeding USD 1 (one) billion (or its equivalent) in a financial year would require prior approval of the Reserve Bank even when the total FC of the Indian Party is within the eligible limit under the automatic route [i.e., within 400% of the net worth (Paid up capital + Free Reserves) as per the last audited balance sheet].

CASE STUDY - 5

Facts of the Case:

1. *HV Company Limited (hereinafter referred as HVCL) manufactures heavy equipment for construction industry.*

2. *An order for supply of 90 Nos. of equipment (T-model dumpers) was received from AB Infra Limited (herein after referred as ABIL). The unit price of the equipment was agreed*

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at ₹ 190 lakhs each. 64 Nos. of equipment were supplied during the year 2017-18 and balance quantity remaining to be supplied as on 31.03.2018. HVCL has 51 Nos. of the equipment in its inventory as on 31.03.2018. HVCL considered that the contract was an onerous contract and therefore, the net realisable value of inventory has been taken as value of inventory as on 31.3.2018. One of the terms of the supply order was that the supplier would be responsible for warranty towards technical defects in the equipment supplied during the two years' period from the date of supply.*

3. *From the details of cost of production and cost of sales, it was pointed out by the auditors of the HVCL that the cost of fulfilling the contract exceeds the economic benefits expected to be received from it. Hence, the contract is onerous and provision towards the same needs to be made.*

4. *The management of HVCL replied to the auditors that Ind AS 37 defines an onerous contract as a contract in which the unavoidable costs of meeting the obligation under the contract exceeds the economic benefits expected to be received under the contract. The unavoidable costs under a contract reflect the least net cost of exiting from the contract by way of compensation or penalties. As per the terms of the contract, if contractor failed to supply, the customer can purchase the equipment at the risk and cost of the defaulting supplier with forfeiture of security deposit as applicable. As the subject contract is on-going contract, such exiting cost cannot be measured. Unavoidable cost does not include allocated share of cost that will be incurred regardless of whether the entity fulfils the contract or not. Moreover, other expenditure like administrative overheads, R&D, finance charges, head quarter expenditure, sales overheads etc., are of the nature of period cost and the purpose of these expenditure related to the said sales order is already completed in 2017-18 itself with receipt of sale order. Hence, there is no non-compliance of Ind AS 37.*

5. *Indian Accounting Standard (Ind AS) 37, 'Provisions, Contingent Liabilities and Contingent Assets' defines an onerous contract as, "a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it". Further, as per Ind AS 37, "the unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfil it." The company believed that unavoidable costs of meeting the obligations under the contract are only costs that: "are directly variable with the contract and therefore incremental to the performance of the contract;" do not include allocated or shared costs that will be incurred regardless of whether the entity fulfils the contract or not; and cannot be avoided by the entity's future actions.*

6. *The management of HVCL has further submitted to the auditor the details of costs that have been considered for creation of provision towards onerous contract:*

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* To be read as 5

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(a) *Material cost - includes cost of material procured, cost of freight & insurance incurred for material procurement and handling, loading and unloading charges incurred.*

(b) *Labour cost/ Factory Overheads - includes salaries and other expenses of direct production department, and also expenses allocated from indirect departments to direct department.*

(c) *Material Overheads - Includes salaries and other expenses (including expenses allocated from other departments) booked under departments linked with materials like purchases, stores and quality control.*

7. *The provision has been made considering the above costs only. For example, the value of provision created for a quantity of 21 Nos. remaining to be produced is as per working shown below:*

Particulars	*Value (₹ in lakhs)*
(i) Cost of production (which includes material cost, labour cost/factory overhead and material overhead)	*199.00*
(ii) Selling price	*190.00*
(iii) Differential cost of 9 Lakh per equipment (No. of equipment remaining to be produced 21)	*189.00*
(iv) Costs incurred towards administrative overheads, finance charges, R & D expenses, sales overhead, head quarter expenditure etc., are considered as period cost and hence not considered for creation of provision.	

8. *HVCL has prepared its computation of taxable income for A.Y. 2018-19 declaring an income of ₹ Nil under the normal provisions and Book Profits under section 115JB of the Income Tax Act of ₹ 8.56 Crores.*

The loss to be returned by the company under normal provisions of the income tax in the return was ₹ 5.23 Crores.

Provide the correct option to the following Questions

Multiple Choice Questions

5.1 *Under the provision of 115JB, the basic rate of income tax applicable on the Book Profit is:*

(a) *15%*

(b) *18.5%*

(c) *22.5%*

(d) *25%*

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5.2 The company covered under the provisions of Section 115JB requires to upload a report from the Chartered Accountant in:

(a) Form -3CA

(b) Form -3CEB

(c) Form-15CB

(d) Form-298

5.3 As per Ind AS 37, a legal obligation is derived:

(a) from legislation.

(b) from a contract (through its explicit or implicit terms).

(c) from any operation of law.

(d) from legislation or from a contract or from any other operation of law.

5.4 In calculating the Book Profit, deduction is allowed with respect to:

(a) brought forward business loss.

(b) unabsorbed depreciation.

(c) brought forward business loss or unabsorbed depreciation whichever is lower.

(d) brought forward business loss or unabsorbed depreciation whichever is higher.

5.5 As per Ind AS 37, an entity shall recognise:

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

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

(c) A contingent liability.

(d) A contingent asset. ***(2 x 5 = 10 Marks)***

Descriptive Questions

5.6 Whether the company's accounting treatment of cost for creation of provision towards onerous contracts is in line with the provisions of Ind AS 37? ***(6 Marks)***

5.7 Please explain how provision for onerous contract made in the books of account have to be dealt with in preparation of computation of taxable income by HVCL for A.Y. 2018-19?

(5 Marks)

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5.8 Please also explain how HVCL shall consider the warranty clause in the supplies of equipment made to ABIL in preparation of computation of taxable income for A.Y. 2018-19? ***(4 Marks)***

ANSWER TO CASE STUDY 5

PART – A

5.1 (a) or (b)

Note - The relevant assessment year for May 2022 examination is A.Y.2022-23 for which the applicable rate under section 115JB is 15%. Accordingly, (a) would be the correct answer. However, in the case study, the facts relate to P.Y.2017-18, when the rate was 18.5%. Accordingly, the answer can be either (a) or (b).

5.2 (d)

5.3 (a) or (b) or (c) or (d) [All the options are correct]

5.4 (c)

5.5 (a)

PART – B

5.6 As per Ind AS 37, onerous contract is a contract in which **the unavoidable costs** of meeting the obligations under the contract exceed the economic benefits expected to be received under it. The unavoidable cost under a contract reflects the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation for penalties arising from failure to fulfilling it.

Ind AS 37 provides that the amount recognised shall be the best estimate of the expenditure required to settle the present obligation, which is the amount that an entity would rationally pay to settle the obligation at the end of the reporting period or to transfer it to a third party at that time. In case of onerous contracts, that an amount that an entity would rationally pay to settle the obligation would be the lower of the compensation or penalties arising from failure to fulfil the contacts and excess of unavoidable cost of meeting the obligations under the contract from the economic benefits expected to be received under it.

The cost of fulfilling a contract comprises the costs that relate directly to the contract. Costs that relate directly to a contract consist of both-

(a) the incremental costs of fulfilling that contract—for example, direct labour and materials; and

(b) an allocation of other costs that relate directly to fulfilling contracts— for example, an allocation of the depreciation charge for an item of property, plant and equipment used in fulfilling that contract among others.

Accordingly, HVCL has correctly measured the cost for creation of provision for onerous contracts by considering material cost, labour cost (to the extent it relates directly to

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production) and material overheads (to the extent it relates directly to production). However, expenses allocated to this department from indirect departments should be avoided in computing the cost for the purpose of creating provision for onerous contracts.

Further, HVCL is correct that the period cost will not be considered for measurement of cost for the purpose of creation of provision on onerous contracts.

5.7 ICDS X deals provisions, contingent liabilities and contingent assets except those resulting from executory contracts.

Whereas Ind AS 37 excludes onerous contracts from the definition of executory contracts, in ICDS X there is no such exclusion. Therefore, when executory contracts are excluded from the purview of ICDS X, onerous contracts, which fall within the meaning of executory contracts, are also excluded from the scope of ICDS X.

Accordingly, as per the provisions of the Income-tax Act, 1961, provision for onerous contracts is **not** allowable as deduction in the hands of HVCL while computing its taxable income.

For computation of book profit under section 115JB for levy of minimum alternate tax (MAT) @15% (*plus* surcharge, if applicable, and HEC@4%), the amount set aside to provisions made for meeting liabilities, other than ascertained liabilities, has to be added back.

Accordingly, provision for onerous contract made in the books of account as is debited to the Statement of profit and loss of HVCL need not be added back, since it represents provision for an ascertained liability. Hence, such provision is deductible while computing book profit for levy of MAT.

Note – The relevant assessment year applicable for May, 2022 examination is A.Y.2022-23, when the rate of MAT is 15%. Accordingly, the rate of 15% has been referred to in the answer, even though the case study contains facts for the year 2017-18 and the question also makes reference to A.Y.2018-19, when the applicable rate of MAT is 18.5%.

5.8 As per ICDS X, a provision has to be recognised when:

(a) a person has a present obligation as a result of a past event

(b) it is reasonably certain that an outflow of resources embodying economic benefits will be required to settle the obligation; and

(c) a reliable estimate can be made of the amount of the obligation. If these

One of the terms of the supply order is that the supplier, HVCL, would be responsible for warranty towards technical defects in the equipment supplied during the two year period from the date of supply.

Provision for warranty has to be recognized as per ICDS X, if it is reasonably certain, from the statistical data, that an outflow of resources embodying economic benefits will be required to settle the obligation.

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If provision for warranty is made on scientific and reliable basis and without such warranty ABIL would not be prepared to buy the equipment, the warranty would become an integral part of the sale price and hence, the provision for warranty would be allowable as business expenditure.

In this case, since provision of warranty is one of the terms of the supply order, it is evident that ABIL would not be prepared to buy the equipment without such warranty. Accordingly, provision for warranty is allowable while computing taxable income under the provisions of the Income-tax Act, 1961, assuming that it is made on scientific basis.

Also, provision for warranty made on scientific and reliable basis is an ascertained liability, Hence, such provision is also allowable while computing book profit for levy of MAT.

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