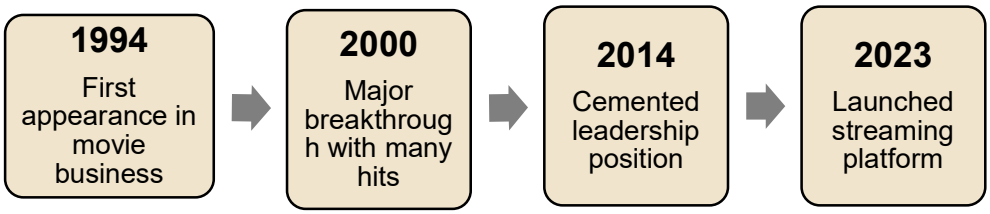
CASE STUDY 1

Journey of Rahul & Raj Films Ltd.

The journey of Rahul & Raj Films Ltd. ("R & R") began in 1994, weaving captivating tales that unfolded on small screen, followed by hitting the big screen in 2000. At the helm of this creative enterprise, is Mr. Shah Ratan Kumar, Ms. Rani Kapoor and Ms. Nutan Dubey orchestrated a symphony of talent and vision, propelling R & R to the forefront of India's entertainment industry. Recognized as pioneers in movie production, The company have carved a niche for itself, enchanting viewers with an array of captivating narratives across various mediums and genres.



The company has established strong Board of Directors comprising seasoned professionals from diverse backgrounds, who bring their expertise and guidance to steer the company towards sustainable growth. The Board exercises prudent oversight, ensuring strategic alignment, risk management and adherence to corporate governance standards. The Board of Directors and senior management details are given as per Annexure -A.

India's Film Industry: A Growing Giant

India's film industry is one of the largest in the world with more than 2,000 motion picture films ('movies') release per year viewed by over 3 billion moviegoers annually. It is ₹ 260 billion industry and is expected to grow to ₹ 600 billion by 2039. The Indian Film Industry comprises of motion picture films produced across India. This industry enjoys mass appeal and is probably the most important content feeder to other businesses in the Media & Entertainment space. Opportunity in the industry lies in meeting the demands of the new age consumer who seeks customized content tailored

to their preferences. This shift in consumer behaviour presents a favourable environment for the company to thrive and capitalize on emerging opportunities. The industry is witnessing the following megatrends:

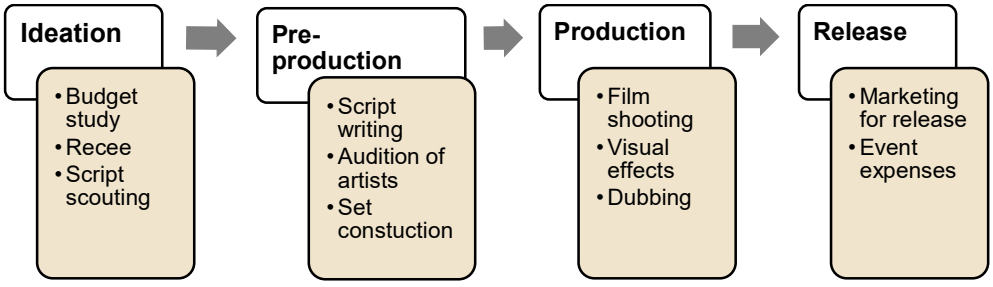
Megatrend 1: Witnessing the adoption of emerging technologies to offer immersive viewing experiences. Virtual Reality and Augmented Reality are being leveraged.

Megatrend 2: With the rise of digitalized communities, brands and platforms are actively incorporating features like 'go live' to build online communities.

Megatrend 3: The globalization of media and entertainment services presents new opportunities for content creators, distributors and advertisers.

Key Business Strategies: Expanding Horizons

R & R, remains committed to producing engaging content, leveraging experience and expertise and expanding customer base. The focus on quality, adaptability and innovation continues to drive success in the dynamic world of entertainment. Movie making broadly involves the following steps:



The key business strategies of R & R are as follows:

- **Expanding into Non-Fiction:** The company also enhances its focus towards non-fiction content and successfully launched 'Locked in' in

the current year, which emerged as the highest-watched movie, showcasing the extensive reach of its business. This success encourages to continue emphasizing transforming passive audiences into engaged prospects by striving to bring more out-of-the-box content-led movies.

- **Quality over Quantity:** The company driven by fundamental principle of choosing quality over quantity when it comes to content. With decades of experience, the enhanced industry knowledge and ability to gauge ongoing and emerging trends have helped the company serve better. The company have built a better understanding of the choices and preferences of audience, enabling it to consistently deliver content that resonates with them.
- **Enhancing User Experience:** While the emphasis remains on connecting with more people in better way The company also stay aligned with the need of the time to adapt to the surrounding changes. Technological upgradation has become an integral part of our business as the company continue to cater to the entertainment needs of audiences through digital platforms. Refer Annexure B for customer feedback.

Box office hits of the current year



New Projects and Strategic Decisions

The movie ‘Simran’ is currently being conceptualised, where the primary focus is on gathering detailed information and developing a solid foundation for the storyline. The project aims to explore the theme of woman empowerment. The objective at this stage is to ensure the story is grounded in accurate, relevant, and engaging content. This includes examining historical contexts, cultural elements, scientific data, or other relevant fields

to enhance the authenticity and depth of the narrative. The next steps involve synthesizing the gathered information into a coherent storyline, developing character profiles, and creating a detailed plot outline. Collaboration with subject matter experts will continue to ensure the highest level of accuracy and authenticity in the portrayal of the chosen themes.

The company decided to abandon the movie 'Kaleen Bhaiya'. The decision to abandon the movie project was primarily due to the story not meeting the desired standards. Despite multiple revisions and considerable effort from the writing team, the narrative failed to captivate and engage in the way that was envisioned. The lack of a compelling and cohesive storyline made it difficult to move forward with production. The team agreed that it would be best to discontinue the project rather than invest further resources into a script that did not meet the creative expectations.

Music Rights and Revenue Growth

In India, music is an important feature of motion picture films. Music rights are generally sold to music companies during the production stage itself. As music plays an important role in the marketing of a motion picture film, music companies release the soundtrack prior to the theatrical release. These rights are generally assigned to the music company in perpetuity for a fixed fee. Where the producer has right to future royalty after achievement of threshold sales by the music company, royalty income is recognized as earned, when communicated/ confirmed by the music company.

On 1st September 2023, the company grants music rights of its three upcoming movies to 'GOLD', a music company for ₹ 3,000 lakhs receivable on date of contract signing. The contract condition stipulates that proportionate amount shall be refunded in case of non-release of music of any of the three movies. The music rights are made available to the music company for the first film on 1st December 2023, second film on 1st January, 2024 and for the third film on 1st July, 2024.

During the F.Y. 2023-24, R & R continued to thrive across various mediums, delivering captivating content that resonated with the audiences. The Group reported 76% increase in revenue to ₹ 593 crores vis-à-vis ₹ 337 crores in the previous financial year. Cost of production also increased to ₹ 511 crores vis-à-vis ₹ 327 crores in the previous

financial year in line with increase in production hours, crossing the milestone of producing more than 1,000 hours of content during the fiscal year. EBIDTA loss at ₹ 19 crores was narrowed by 84% in the current financial year over loss of ₹ 122 crores in the previous financial year. The company has improved its accounts receivable collection efficiency, reducing the sales outstanding from 164 to 160 days

Auditor Engagement and Concerns

Ranveer and Ranbir LLP are appointed as auditors of the company since last 4 years. The firm's audit & assurance practise in different sectors including Media & Telecommunications is dedicated to delivering exceptional quality and innovative solutions with team of experienced professionals who offer in-depth industry expertise and insightful audits, ensuring that clients receive the highest level of assurance. The firm is an auditor to many of the country's most recognizable brands in the market today.

Considering the continuance of audit, the engagement partner is deliberating whether a new engagement letter should be sent for the audit of the current F.Y. ended 31st March, 2024. Till last year, an engagement letter was sent for audit of every F.Y. despite no change of laws and regulations, auditors/management responsibilities.

During the audit engagement, the auditor observed that the days outstanding are significantly higher than industry averages and decided to obtain independent balance confirmations of trade receivables. The confirmation letter requests the customer to respond directly to the auditor indicating whether the party agrees or disagrees with the information in the request or provide the requested information. Based on previous experience, the auditor believed that the responses to the confirmation requests would be insufficient. This is primarily due to the fact the company works in an unorganised sector and every customer may not readily maintain updated books and records. Also due to lack of interest, customers may generally be reluctant in confirming balances.

Subsidiary Operations and Market Position

R & R operates movie theatres in different parts of the country through the following group entities:

Mangla Talkies Ltd.

Established 10 years ago in Mumbai with the strategic objective to identify movie theatres at different parts of the country and secure time slot of exhibitions and other logistical aspects. At the moment logistical related aspects of about 50% of the movies exhibited by R & R is handled by this subsidiary. In recent years, competition between theatre owners has intensified. It has been estimated that total annual turnover for the movie exhibition in the country has fallen by 5% in the past two years. The estimated market share of Mangla Talkies, which operates the fifth largest movie logistics management company, has fallen from 14% to 13% in the same period. It has a low-profit margin.

Prospects for the entertainment industry is uncertain, partly because of lower box office collections but also because of availability of alternate entertainment avenues. OTT platforms have limited the number of movies that are released each year. There is concern that the OTT platform will reduce movie production over time.

Sangam Theatres Ltd.

Sangam Theatres was acquired about 20 years ago when it was a newly established company. At the moment about 50% of the movies released by R & R is exhibited by Sangam Theatres. R & R used government grants, available at the time (but no longer) to invest in modernisation of the theatre. Sangam Theatres is now a leading theatre operator, and it attracts a large amount of its business from other companies, partly because of its operating capabilities but also because of its relatively low costs. The low costs are achievable because Sangam Theatres uses relatively modern equipments having larger capacities. The market is fairly static, increased in size by just 2% in the past two years. Annual turnover for Sangam Theatres has risen by 8% in the same period, and its profits are also rising. Sangam Theatre also exhibits movies of other movie producers.

Payal Movies Ltd.

Payal was acquired 7 years ago as a strategic response to the declining regional movie market. It operates several movie theatres at various states. R & R has experienced problems with Payal Movies since its acquisition. Operating costs have been higher than expected. Over the past 2 years the market has increased by 20%. Annual revenue of has risen by 12% in the same period, but its annual profits have risen only slightly.

Vijay Screens Ltd.

R & R established a subsidiary company - Vijay Screens to create a platform for documentaries and similar movies created by the upcoming directors. Competition in the business is strong, and profit margins for Vijay Screens are narrow, but R & R considered that owning a platform for documentary movies would give it greater control over its movies' portfolio.

ANNEXURE-A

The Board of Directors of R&R comprises of following persons:

Mr. Shah Ratan Kumar ***Promoter and Non-Executive Chairman***	A celebrated movie star and starring in more than 200 movies in his career of 50 years. He is particularly popular as a romantic lead. He is also a reputed film producer. He has won a number of prestigious awards, including the Lifetime Achievement Award, as well as Dadasaheb Phalke Academy Award
Ms. Rani Kapoor ***Promoter and Managing Director***	Has been in charge of company's operational management and efficiency and in controlling 'on set' activity. She has won a number of prestigious awards including CEO of the Year and Businesswoman of the Year. Earlier the position was held by Mr. A. Suleiman.
Ms. Nutan Dubey ***Promoter and Joint Managing Director***	Undertakes the day-to-day creative direction of movies produced by the company. She has won a number of prestigious awards, including the Businesswoman of the Year and Entrepreneur of the Year.
Ms. Sanna Mukherjee ***Independent Director***	An industry veteran with over three decades of experience in the media and entertainment business. Appointed as CEO of Vianet19 to drive its transition into a truly integrated media company across broadcast and digital, and across entertainment and sports in over 8 languages. Her initial appointment as an Independent Director was for 1 year and was then reappointed for another term of 5 years which

	would end on 30th July, 2024. The Board proposes to appoint her for another term of 5 years. If her appointment proposal is accepted as per applicable laws and regulations, Ms. Sanna will attain 68 years of age on completion of her third term.
Mr. S. Dutt ***Independent Director***	Chartered Accountant by profession and is a Life & Fellow Member of the Institute of Chartered Accountants in England and Wales and a Fellow Member of the Institute of Chartered Accountants of India. He was a partner at CA firm, Salman & Aamir from 1969 and was the Senior Partner (Chairman) of the firm from 1989 till 1999.
Mr. Prem Naryan Chopra ***Group CFO***	A Chartered Accountant by profession and is a Life & Fellow Member of the Institute of Chartered Accountants in Australia and a Fellow Member of the Institute of Chartered Accountants of India. He also served as the Chairman of the Direct Taxation Committee of the Southern India Chamber of Commerce & Industry and was a member of the Board of Governors of the Doon School, Dehradun. Earlier this position was held by Amrish Nath till last year.
Ms. Juliya Jain ***Group Head – Secretarial***	Joined the company in the current year and holds a Bachelor's Degree in Commerce and a Bachelor's Degree in Law from the University of Delhi. She has over 36 years of rich experience in the Finance, Capital Markets, Banking, General Corporate Advice and Regulatory Practices. She was a Senior Partner at BZA Legal, Executive Vice President and Head of Legal & Compliance Department at Credit Bank Ltd. Previously this position was held by Ms. Deepika Singhal.

ANNEXURE-B

EXTRACTS FROM CUSTOMER'S FEEDBACK
Yusuf J., Friday, 4:00 p.m., August 15, 2024
At Rahul & Raj, I believe that the movie-going experience doesn't end when the credits roll. Every visit to Sangam Theatres is an opportunity to create lasting memories, and I'm committed to making each one better than the last. ★★★
Thank you so much for your kind words! We're thrilled to hear that you had such a positive experience at Sangam Theatres. We've worked hard to make sure every visit is as seamless and enjoyable as possible; from the moment you park to the end.
Tina M., Friday, 2:30 p.m., August 15, 2024
While I've always enjoyed watching movies at Mangla Talkies, my recent visit left me with mixed feelings. The movie itself was fantastic, but I noticed that the service

quality has slipped a bit. The concession stand took longer than usual, and the seating wasn't as comfortable as I remembered. ★☆☆

Thank you for sharing your experience. We truly appreciate your loyalty to Mangla Talkies and sorry to hear that your recent visit didn't meet your expectations. Your feedback is invaluable, and we want you to know that we're taking it seriously. We're already looking into the service delays at the concession stand and the seating comfort, and we're committed to making improvements. We hope you'll notice the difference on your next visit, and We look forward to welcoming you back to a better experience soon.

I. Multiple Choice Questions

1.1 Should the auditor send an engagement letter for the audit of the current financial year of R & R? Choose the correct statement.

(a) New engagement letter should be sent if there is recent change of senior management or similar at R & R.

(b) New engagement letter should be sent every year including recurring audit engagements under the Companies Act, 2013.

(c) It is optional to obtain to new engagement letter for recurring audit engagements as envisaged under SA 210.

(d) The Companies Act, 2013 mandates auditors to obtain engagement letter for every audit.

1.2 What type of confirmation request have been designed by the auditor while auditing trade receivables?

(a) Negative confirmation request

(b) Positive confirmation request

(c) Hybrid confirmation request

(d) Blank confirmation request

1.3 What amount of revenue from music rights be recognised in the financial statements of FY 2023-2024?

(a) ₹ 2,000 lakhs

(b) ₹ 3,000 lakhs

(c) ₹ 1,000 lakhs

(d) ₹ 593 crores

1.4 Can Ms. Sanna Mukherjee be reappointed as an independent director for another term of 5 years?

(a) Under the Companies Act, 2013, an independent director can be appointed for a maximum period of 10 years. Ms. Sanna Mukherjee can be reappointed as an independent director for the remaining period of 4 years.

(b) Under the Companies Act, 2013, an independent director can be appointed for 2 consecutive terms – each term being 5 years (i.e. 10 years). Ms. Sanna Mukherjee can be reappointed as an independent director for another term of 5 years since her first term was lesser period (i.e. 1 year instead of 5 years) as provided under the Companies Act, 2013.

(c) Under the Companies Act, 2013, an independent director can be appointed for maximum 2 consecutive terms – each term can be upto 5 years (i.e. 10 years). Ms. Sanna Mukherjee cannot be reappointed as an independent director since she would attain 68 years of age on completion of the proposed term of 5 years. Any person attaining 68 years of age cannot be appointed as an independent director.

(d) Under the Companies Act, 2013, an independent director can be appointed for maximum 2 consecutive terms – each term can be upto 5 years (i.e. 10 years). Ms. Sanna Mukherjee cannot be reappointed as an independent director since she has completed 2 consecutive terms. Appointment for a term less than 5 years is treated as one term.

1.5 Whether the cost of production of 'Kaleen Bhaiya' can be claimed as a deduction while filing ITR by the company?

(a) Cost of production of abandoned movie can be claimed as a deduction while filing ITR by the company as a capital expenditure.

(b) Cost of production of abandoned movie can be claimed as a deduction while filing ITR by the company as revenue expenditure.

(c) Deduction of cost of production cannot be claimed under Rule 9A of the Income Tax Rules 1962, since the movie was not certified for release by Board of Censors.

(d) Deduction of cost of production can be claimed under Rule 9A of the Income Tax Rules 1962, since the cost of production did not exceed the monetary limit of ₹ 500 crores prescribed in aforesaid Rule.

II. Descriptive Questions

1.6 EVALUATE the intricate value chain of R & R, focusing on the production, acquisition, distribution, and exhibition of movies. DISCUSS the operational challenges in each stage and how they affect the company's efficiency and overall success.

1.7 Whether the production of the movie 'Simran' is at the research or development stage under the relevant Ind AS. Explain the accounting treatment for the cost incurred till date with respect to the said movie?

1.8 Explain the reason for obtaining independent confirmation prescribed under SA 505? What alternate procedures should the auditors, Ranveer and Ranvir LLP, perform if the response of independent confirmation of trade receivable was inadequate?

ANSWERS TO THE CASE STUDY 1

I. Answers to the Multiple Choice Questions

1.1 (a) New engagement letter should be sent if there is recent change of senior management or similar at R & R.

Reason: Paragraph A29 of SA 210 provide that the auditor may decide not to send a new audit engagement letter or other written agreement each period unless factors exist (e.g. a recent change of senior management) to make it appropriate to revise the terms of audit engagement.

1.2 (b) Positive confirmation request

Reason: The auditor has designed a positive confirmation request. A positive external confirmation request asks the confirming party to reply to the auditor in all cases, either by indicating the confirming party's agreement with the given information, or by asking the confirming party to provide information. A response to a positive confirmation request ordinarily is expected to provide reliable audit evidence.

1.3 (a) ₹ 2,000 lakhs

Reason:

Accounting year	Particulars	Revenue (₹ in lakhs)
YE 31 March 2024	Music of first and second movie made available during the year ended 31st March, 2024	2,000
YE 31 March 2025	Music of third movie made available to the music company on 1st July, 2024*	1,000

*Had the third movie been shelved during the year ended 31 March 2024, the amount of ₹ 1,000 lakhs would have been refundable to the music company.

1.4 (d) Under the Companies Act, 2013, an independent director can be appointed for maximum 2 consecutive terms – each term can be upto 5 years (i.e. 10 years). Ms. Sanna Mukherjee cannot be reappointed as an independent director since she has completed 2 consecutive terms. Appointment for a term less than 5 years is treated as one term.

Reason: MCA has clarified that an independent director can be appointed for a term of less than 5 years. However, any appointment whether of 5 or less than 5 years will be regarded as 'one term'. Section 149 (11) of the Companies Act, 2013 clearly stipulates that no person can hold office as an independent director for more than 'two consecutive terms'. Thus, irrespective of the duration of each of the two terms (whether the same aggregates to 10 years or less) a person

holding office for two consecutive terms shall be eligible for re-appointment only after the expiry of three years of ceasing to become an independent director.

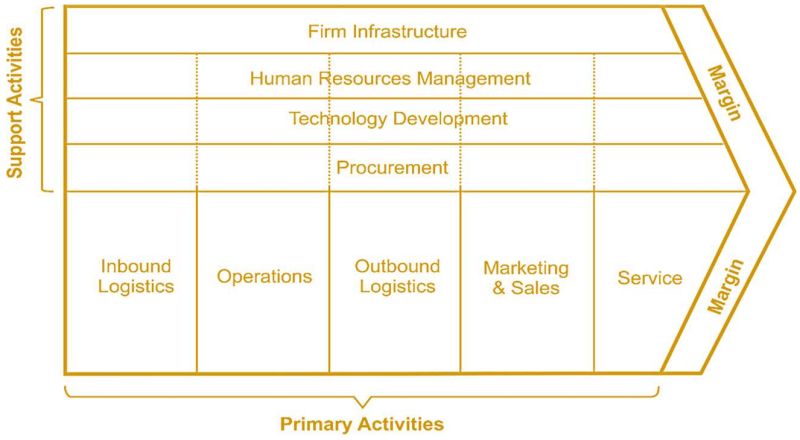
1.5 (b) Cost of production of abandoned movie can be claimed as a deduction while filing ITR by the company as revenue expenditure.

Reason: CBDT has clarified vide *Circular No. 16, dated 6.10.2015* that Rule 9A does not apply to abandoned feature films and that the expenditure incurred on such abandoned feature films is not to be treated as a capital expenditure. The cost of production of an abandoned feature film is to be treated as revenue expenditure and allowed as per the provisions of section 37 of the Income-tax Act, 1961.

II. Answers to the Descriptive Questions

1.6 Evaluation of the Value Chain of Rahul & Raj Films Ltd.

The value chain of R & R can be assessed by analyzing its primary and support activities that contribute to creating value and maintaining a competitive advantage in the entertainment industry. R & R engages in the production and acquisition of movies as well as distribution and exhibition.



Primary Activities

Inbound Logistics

In the context of R & R, inbound logistics plays a critical role in the company's ability *to consistently deliver high-quality content*.

The company's strategy of prioritizing quality over quantity is reflected in their meticulous approach to inbound logistics, where *careful planning and resource allocation are paramount*. Efficient management of these resources allows R & R to maintain a streamlined production process, minimizing delays and optimizing costs, which is crucial in an industry where time-to-market can significantly impact a film's success. This robust inbound logistics framework supports the company's overarching strategy of delivering captivating and innovative content, thereby strengthening its position in the competitive Indian film industry.

Operations

R & R has a strong presence in movie production and exhibition, largely due to its ownership of Sangam Theatres and Mangla Talkies. Sangam Theatres, a successful acquisition, has been modernized to improve profitability, while Mangla Talkies handles logistical operations for movie exhibitions (Outbound Logistics). The vertical integration of these operations ensures smooth transitions from production to exhibition, enhancing the company's control over its value chain.

Outbound Logistics

R & R's outbound logistics are crucial, particularly in the **distribution of movies** through its theatre chains and digital platforms. A key player in this process is Mangla Talkies, which manages the distribution logistics and ensures that movies are released on time and in an efficient manner. The company's integration across different stages of the value chain has significantly enhanced its ability to oversee and manage the distribution process effectively.

However, despite the strong performance of Sangam Theatres, the decline in Mangla Talkies' market share indicates a need for the company to reassess its distribution strategies. This reassessment is vital not only for maintaining its current market coverage but also for expanding it in the increasingly competitive landscape.

The rise of OTT platforms further complicates the situation, posing a substantial challenge to traditional movie exhibition operations. To maintain relevance and effectively compete with online platforms, it is crucial for the company to modernize its theatres and integrate digital technology into its operations. This modernization will ensure that R & R remains competitive in a rapidly evolving industry.

Marketing and Sales

R & R has built a strong brand in the Indian film industry, particularly through its focus on quality content and diversification into regional and niche markets. The company's strategic positioning in the movie exhibition space allows it to leverage its brand for both mainstream and niche content.

The company's ventures into niche markets through Vijay Screens demonstrate an effort to cater to diverse audience preferences. However, with the growing influence of OTT platforms, the company needs to enhance its marketing strategies, possibly integrating digital marketing and *partnerships with online platforms* to reach broader audiences.

Service

For R & R, the after-sale service value chain is a strategic tool that not only enhances customer satisfaction but also differentiates the brand in a competitive landscape. Maintaining an ongoing dialogue with customers through personalized communication, whether via email newsletters or social media interactions, helps in keeping them connected with the brand. This engagement fosters a loyal customer base that is more likely to return for future screenings.

The feedback from customers like Yusuf J. and Tina M. highlights the critical role that after-sales service plays in the overall value chain at R & R. At Sangam Theatres, the commitment to enhancing the movie-going experience from start to finish has resulted in positive customer experiences, reinforcing the importance of maintaining high standards in service quality, convenience, and comfort. However, the feedback from Mangla Talkies suggests areas where service can be strengthened, particularly in addressing service delays and seating comfort. These insights underscore the need for continuous improvement in customer engagement, issue resolution, and facility upgrades.

By actively responding to customer feedback and making necessary adjustments, R & R can ensure that every visit, whether to Sangam Theatres or Mangla Talkies, leaves a lasting positive impression, ultimately strengthening its position in the competitive entertainment industry.

Support Activities

Firm Infrastructure

The company's strategic acquisitions and vertical integration are key components of its infrastructure. However, the management must address inefficiencies in regional operations and adapt to the changing technological landscape to sustain growth.

The modernization of Sangam Theatres has been successful, but similar efforts may be needed across other subsidiaries, particularly those struggling with operational inefficiencies. While the company has seen revenue growth, particularly in regional markets, the higher-than-expected operating costs suggest a need for better financial management practices, especially in cost control and resource allocation.

Human Resource Management

The success of R & R's operations depend on its ability to attract and retain skilled professionals in movie acquisition, production, distribution, and exhibition. Investment in training and development is crucial for maintaining high operational standards and adapting to industry changes.

With challenges in managing operating costs at Payal Movies, there may be a need for improved human resource management practices to enhance employee efficiency and reduce costs.

Technology Development

The company's ability to integrate new technologies into its operations, such as digital projectors in theatres and partnerships with OTT platforms, is critical for maintaining competitiveness. Investment in R&D for innovative exhibition formats and digital platforms could create additional value.

Procurement

The process begins with ***securing top-tier scripts and story ideas, which serve as the foundation for the company's productions***. Given the company's focus on both fiction and non-fiction genres, the selection and acquisition of compelling narratives are vital. This includes purchasing rights to intellectual properties, collaborating with accomplished directors, and bringing on board renowned actors, all of which are essential inputs in the filmmaking process.

The company's procurement strategies for acquiring content and technology are essential for maintaining quality standards. Developing strong relationships with content producers and technology suppliers can ensure access to high-quality inputs at competitive prices.

The higher operating costs at Payal Movies highlight the importance of effective procurement strategies in managing expenses and maximizing profitability.

Conclusion

R & R has established a comprehensive value chain that integrates multiple stages of the film industry, from content acquisition to exhibition. The company's strategic acquisitions and modernization efforts have created value across its primary and support activities. However, challenges in managing operational costs, particularly in regional markets, and adapting to technological shifts suggest areas for improvement. By enhancing its technology development, human resource management, and procurement strategies, Rahul & Raj can strengthen its value chain and sustain its competitive advantage in the evolving entertainment industry.

1.7 Determination of research and development assumes significance for self - generated intangible assets as capitalisation of cost are permitted only from such time as recognition criteria Ind AS 38 are met. Under Ind AS 38, research is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding. Whereas development is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services prior to the commencement of commercial production or use.

As per paragraph 57 of Ind AS 38, no intangible asset arising out of research phase of an internal project should be recognised. Thus, an intangible asset can be recognised only on the commencement of the development stage where the intangible asset can be identified, and the entity can demonstrate that future economic benefits are probable from the asset. Further, as per para 58 of Ind AS 38, an intangible asset arising from development or from the development phase of an internal project demonstrates that the asset will generate future economic benefits because development phase is further advanced than the research phase.

In a movie production cycle, the ideation phase is likely to be 'research' that is undertaken with the prospect of understanding the potential market for such a movie. Expenses, incurred prior to the date of the finalization of concept should be expensed considering the same as a cost in the research phase. This is because in the research phase of a project, it cannot be demonstrated that an intangible asset exists from which future economic benefits are probable.

In the extant case, there is no identification of key cast and crew or the location. The filming set is also being deliberated and have not yet been finalised. Booking of the lead star cast is pending. Date of shooting has not been frozen. Accordingly, the production of movie 'Simran' is at the research phase. Thus, cost incurred till date cannot be capitalised and should be expensed out in the statement of Profit and Loss when it is incurred.

1.8 External confirmation procedures are an effective and efficient way to obtain audit evidence about financial statement assertions such as trade receivable with number of days outstanding – being significantly higher than industry average. External confirmations also help auditor obtain audit evidence from third parties with a high level of reliability when responding to significant risks. Decision whether to use external confirmation procedures requires significant judgement as envisaged in SA 505 including the objectivity of the confirming party and the willingness of the confirming party to respond.

The auditor should exercise an appropriate level of professional skepticism throughout the confirmation process. Professional skepticism is important in designing the confirmation request, performing the confirmation procedures and evaluating the results of the confirmation procedures.

When the auditor do not receive replies to positive confirmation requests, the auditor as required under SA 505 apply alternative procedures to the non-responses to obtain the evidence necessary to reduce audit risk to an acceptably low level. The nature of alternative procedures to be performed varies according to the account and assertion.

Alternative procedures related to the confirmation of trade receivables may include examination of subsequent cash receipts or other entity documentation to provide evidence for the existence assertion. The auditor should evaluate the combined evidence provided by the confirmations and the alternative procedures performed to determine

whether it is sufficient to achieve our audit objectives and if it is relevant and reliable.

If the combined evidence provided by the confirmations, alternative procedures and other procedures is not sufficient, the auditor should request additional confirmations or perform other tests, such as tests of details or analytical procedures, to the extent needed to obtain the desired audit evidence.

CASE STUDY 2

Dev Products Ltd. (DPL): A Journey of Strategic Growth

Founded in the heart of India's industrial hub, Lucknow, in the early 1980s, Dev Products Ltd. (DPL) began its journey as a modest manufacturing unit specializing in agricultural implements. The company's entrepreneurial spirit and a keen understanding of rural India's needs propelled its initial growth. Recognizing the burgeoning construction sector, DPL expanded its product line in the late 1990s to include basic building materials. This strategic move proved to be a cornerstone in solidifying the company's position in the market.

Over the decades, DPL consistently reinvested its profits into research and development, enabling it to diversify its product portfolio. The early 2000s witnessed DPL's foray into the consumer durables market with the introduction of essential home appliances. This expansion was driven by the growing middle class and the increasing demand for modern conveniences. The company's commitment to quality and affordability quickly garnered a loyal customer base. By the mid-2010s, DPL had established itself as a formidable force in the Indian manufacturing industry. The company's ability to adapt to evolving market trends and consumer preferences allowed it to navigate economic challenges and emerge stronger. A strategic focus on building a robust distribution network and prioritizing customer satisfaction further cemented DPL's position as a trusted brand.

The company’s product portfolio is strategically categorized to cater to different market segments, offering a comprehensive range of building materials essential for various construction projects, including pipes, wires, electrical fittings, and prefabricated building components. In the home

appliances sector, DPL meets the needs of modern households with a selection of essential appliances like refrigerators, washing machines, and water purifiers, potentially expanding to include smaller appliances like kettles or toasters. Recognizing the importance of long-lasting consumer durables, DPL's offerings in this category include products like bicycles, furniture, and even electronics like televisions. Beyond product diversification, DPL prioritizes exceptional customer service and has established a robust distribution network across North India, ensuring easy product availability for retailers and consumers. Additionally, DPL emphasizes responsive after-sales support through a network of service centres, fostering customer satisfaction and brand loyalty.

Strategic Acquisition of BDM Ltd.

In a strategic move to enhance synergy and expand its market presence, Dev Products Ltd. (DPL) acquired BDM Ltd. BDM Ltd. is projected to generate an expected free cash flow of ₹ 2 crores for the upcoming year, with a forecasted growth rate of 5%. The company's cost of equity is calculated at 12%, while the after-tax cost of debt stands at 6%. Notably, the market value of BDM Ltd.'s equity is estimated to be three times its book value, whereas the book value as well as the market value of its debt is equivalent to book value of equity.

The acquisition process saw significant milestones, beginning with the receipt of the certified copy of the order of amalgamation from the National Company Law Tribunal (NCLT) on 26th April 2023. This document, dated 25th April 2023, was subsequently filed with the Registrar of Companies (ROC) for registration on 2nd May 2023, within the stipulated timeline. The amalgamation was officially registered by the ROC on 10th May 2023, with the scheme of amalgamation indicating an appointed date of 5th May 2023.

Initially, BDM Ltd. was valued at ₹50 crores by an analyst for the purpose of amalgamation. However, a registered valuer of DPL later discovered that the analyst had utilized the book values of debt and equity in his calculations, which necessitated a revision of BDM Ltd.'s value in the amalgamation scheme. As a part of the acquisition, DPL also gained two valuable trade secrets from BDM Ltd. — 'Design A,' a patented interlocking bricks design, and 'Design B,' which pertains to the internal component design of bricks but lacks legal protection.

Legal Challenges and Risk Management

To commemorate two significant milestones—the successful acquisition of BDM Ltd. and the 25th anniversary of its founding—Dev Products Ltd. (DPL) hosted a grand celebration for the major shareholders of both companies. However, the festive atmosphere was soon overshadowed by a controversy that emerged in the media, shedding light on legal issues involving a former director of BDM Ltd. This unexpected revelation posed a significant legal challenge for DPL, as the company had to address the complexities surrounding the personal liability of directors for actions taken before the acquisition.

Following the acquisition, DPL's management prioritized strengthening its internal controls to ensure smooth integration of the merged entities and to mitigate potential risks. As part of this initiative, DPL's management met with their statutory auditors, LR & Co., to discuss implementing a risk-based audit approach. To further bolster its internal controls, particularly in Accounts & Finance, DPL purchased standardized finance software at a list price of ₹15 lakhs, paying ₹0.25 lakh towards non-refundable purchase tax. The company was also granted a trade discount of 5% on the initial list price and incurred a cost of ₹3.5 lakhs for customizing the software for its intended use. Additionally, DPL secured a 5-year maintenance contract with the vendor company for ₹ 1 lakh.

Audit and Financial Reporting

During the audit of DPL's consolidated financial statements for the year 2023-24, which are required to be prepared in accordance with Division II of Schedule III to the Companies Act, 2013, CA Lokesh, the engagement partner from LR & Co., noticed important details. The notes to the accounts in respect of consolidated financial statements disclosed additional information pertaining to the holding company and its subsidiaries. This included percentages of consolidated net assets, consolidated profit and loss, and total comprehensive income, along with their respective amounts. Additionally, during the year 2023-24, goodwill of ₹10 crores arose from the acquisition of a subsidiary, with no impairment loss as of the balance sheet date. Adjustments were made in the consolidated financial statements concerning intra-group indebtedness and harmonizing different accounting policies adopted by the parent and its subsidiaries.

DPL's journey from a small manufacturing unit to a leading player in multiple sectors showcases its strategic foresight and adaptability. The recent acquisition of BDM Ltd. and the company's ongoing efforts to strengthen internal controls reflect DPL's commitment to sustainable growth and strong governance.

ANNEXURE

City Times

Lucknow, May 15, 2024 — In the aftermath of a high-profile corporate amalgamation, Mr. Ashok, a former director of BDM Ltd., finds himself embroiled in a legal controversy that could have significant implications for corporate governance and accountability. The amalgamation, which saw BDM Ltd. being acquired by Dev Products Ltd. (DPL), has brought to light a series of alleged offenses committed by Mr. Ashok in violation of the Companies Act, 2013.

Mr. Ashok, who was a key figure in BDM Ltd. before the company's amalgamation with DPL, is now under scrutiny for actions that reportedly breached corporate regulations. The offenses, which include several violations of the Companies Act, 2013 were committed prior to the completion of the amalgamation. However, Mr. Ashok is attempting to distance himself from the legal consequences of these actions, arguing that since the offenses occurred before the amalgamation, he should not be held liable for any resulting penalties or punishments.

Legal experts are closely watching the case, as it raises important questions about the extent of personal liability for directors in the context of corporate mergers and acquisitions. The key issue at hand is whether a director can be absolved of responsibility for actions taken before a amalgamation simply because the company has changed ownership or structure.

I. Multiple Choice Questions

2.1 From the following options you are required to choose the correct 'effective date' of amalgamation:

(a) 25/04/2023

(b) 26/04/2023

(c) 10/05/2023

(d) 05/05/2023

2.2 Under McKinsey's 7S framework, DPL's acquisition of BDM Ltd. and subsequent efforts to strengthen internal controls would most likely be classified under:

(a) Strategy and Systems

(b) Shared Values and Skills

(c) Structure and Staff

(d) Style and Strategy

2.3 At what cost the intangible asset i.e. the finance software will be recognised by DPL?

(a) ₹ 17.95 lakhs

(b) ₹ 18 lakhs

(c) ₹ 18.2 lakhs

(d) ₹ 17.75 lakhs

2.4 Considering disclosure of additional information in consolidated financial statements, which of the following statements is correct?

(a) The said disclosure is not proper as percentage of consolidated revenue from operations along with respective amount pertaining to holding company and its subsidiaries is also required.

(b) The said disclosure is not proper as percentage of other comprehensive income along with respective amount pertaining to holding company and its subsidiaries is also required.

(c) The said disclosure is not proper as percentages of consolidated revenue from operations as well as other comprehensive income along with their respective amounts pertaining to holding company and its subsidiaries are also required.

(d) The said disclosure is proper.

2.5 Which of the following statements best reflects the proper treatment of goodwill and the other consolidation adjustments within the context of these financial statements?

(a) Goodwill represents current period consolidation adjustments. Adjustments relating to intra-group indebtedness and those relating to harmonizing different accounting policies being adopted by the parent and its subsidiaries represent permanent consolidation adjustments.

(b) Adjustments relating to goodwill, intra-group indebtedness and those relating to harmonizing different accounting policies being adopted by parent and its subsidiaries represent current period consolidation adjustments.

(c) Goodwill represents permanent consolidation adjustments. Adjustments relating to intra-group indebtedness and those relating to harmonizing different accounting policies being adopted by the parent and its subsidiaries represent current-period consolidation adjustments.

(d) Goodwill and adjustments relating to harmonizing different accounting policies being adopted by the parent and its subsidiaries represent permanent consolidation adjustments. Adjustments relating to intra-group indebtedness represent current period consolidation adjustments.

II. Descriptive Questions

2.6 How should DPL APPLY the relevant Indian Accounting Standards (Ind AS) to account for the acquisition of Design A and Design B and at what amount?

2.7 Determine the accurate valuation of BDM Ltd. as calculated by the registered valuer of DPL, and provide an ANALYSIS based on the revised valuation.

2.8 Can Mr. Ashok be absolved of responsibility for actions taken prior to the acquisition solely because the company has undergone a change in ownership or structure? COMMENT.

ANSWERS TO THE CASE STUDY 2

I. Answers to the Multiple Choice Questions

2.1 (d) 05/05/2023

Reason: Section 232(6) of the Companies Act, 2013, the scheme under this section shall clearly indicate an appointed date from which it shall be effective and the scheme shall be deemed to be effective from such date and not at a date subsequent to the appointed date.

Here, the scheme of such amalgamation had indicated an 'appointed date' - 05/05/2023 and accordingly, the effective date' of amalgamation would be 05/05/2023.

2.2 (a) Strategy and Systems

Reason: Under McKinsey's 7S framework, "Strategy" refers to the plan devised to maintain and build a competitive advantage over the competition. DPL's acquisition of BDM Ltd. is a strategic move aimed at enhancing synergy, expanding market presence, and strengthening its product portfolio. This aligns with the "Strategy" aspect of the 7S framework.

"Systems" refers to the processes and procedures used to manage the organization. The efforts to strengthen internal controls post-acquisition—such as implementing a risk-based audit approach and purchasing standardized finance software—are related to the "Systems" aspect. These efforts are aimed at ensuring smooth integration of the merged entities and improving governance.

Therefore, the acquisition and subsequent focus on internal controls fit within the "Strategy and Systems" elements of McKinsey's 7S framework.

2.3 (b) ₹ 18 lakhs

Reason: In accordance with Ind AS 38 'Intangible Assets', the cost of a separately acquired intangible asset is its purchases price and non-refundable purchase taxes, after deducting trade discounts and rebates and any directly attributable cost of preparing the asset for its intended use. Therefore, the initial cost of the intangible asset should be:

Particulars	₹
List price	15,00,000
Less: Trade discount (5%)	(75,000)
Non-refundable purchase tax	25,000

Customisation cost	3,50,000
Total cost	18,00,000

The maintenance contract of ₹ 1,00,000 is an expense and therefore should be taken as a prepaid expense and charged to profit and loss over a period of 5 years.

2.4 (b) The said disclosure is not proper as percentage of other comprehensive income along with respective amount pertaining to holding company and its subsidiaries is also required.

Reason: In addition to the information required pursuant to Schedule III to the Companies Act, 2013 ('general instructions for the preparation of consolidated financial statements') following information is also required to be disclosed in the consolidated financial statements separately for the parent and each of its components (including foreign component) which has been consolidated:

(i) amount of net assets and net assets as a percentage of consolidated net assets;

(ii) amount of share in profit or loss and the percentage share in profit or loss as a percentage of consolidated profit or loss;

(iii) amount in other comprehensive income (OCI) and the percentage of OCI as a percentage of Consolidated OCI.

2.5 (c) Goodwill represents permanent consolidation adjustments. Adjustments relating to intra-group indebtedness and those relating to harmonizing different accounting policies being adopted by the parent and its subsidiaries represent current-period consolidation adjustments.

Reason: Permanent consolidation adjustments are those adjustments that are made only on the first occasion or subsequent occasions in which there is a change in the shareholding of a particular entity which is consolidated. Examples are determination of goodwill or capital reserve, equity attributable to minority shareholders.

Current period adjustments are those adjustments that are made in the accounting period for which the consolidation of financial

statements is done like elimination of intra-group transactions and account balances.

II. Answers to the Descriptive Questions

2.6 Ind AS 38, "Intangible Assets," provides detailed guidance on the recognition, measurement, and disclosure of intangible assets, which are non-monetary assets without physical substance. The standard emphasizes the importance of identifying intangible assets distinctly from goodwill, particularly in the context of a business combination.

Identifiability of Intangible Assets

Paragraphs 11 and 12 of Ind AS 38 set out the criteria for an asset to be recognized as an intangible asset:

1. Separable Criterion: An asset is considered identifiable if it is separable, meaning it can be separated or divided from the entity and sold, transferred, licensed, rented, or exchanged, either individually or together with a related contract, identifiable asset, or liability, regardless of whether the entity intends to do so.
2. Contractual-Legal Criterion: An asset can also be identifiable if it arises from contractual or other legal rights, irrespective of whether those rights are transferable or separable from the entity or from other rights and obligations.

Application to Design A and Design B

In the context of a business combination, the identification of intangible assets is critical because they must be recognized separately from goodwill. Goodwill represents the future economic benefits that arise from other assets acquired in a business combination that are not individually identified and separately recognized.

Design A:

Contractual-Legal Criterion: Design A is protected by a patent, which means it arises from legal rights that are enforceable. According to Ind AS 38, an asset that arises from contractual or other legal rights is identifiable as an intangible asset, regardless of whether these rights are transferable or separable. Therefore, Design A meets the contractual-legal criterion and must be recognized as a separate intangible asset in the business combination.

Design B:

Separable Criterion: Although Design B is not protected by a patent and does not meet the contractual-legal criterion, it still qualifies as an intangible asset under the separable criterion. The separable criterion emphasizes that an asset is identifiable if it can be separated from the entity and sold, transferred, licensed, or exchanged. In practice, unpatented designs like Design B can often be exchanged, licensed, or leased to others. This ability to be separated and dealt with independently of the entity fulfills the separable criterion. Consequently, Design B should also be recognized as a separate intangible asset in the business combination.

Measurement

Once identified, these intangible assets must be measured at their fair value at the acquisition date, as per Ind AS 103, "Business Combinations," which is closely aligned with Ind AS 38. The fair value reflects the price that would be received to sell the asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

2.7 Step 1: Calculate Correct Weights

- Let E = Market value of equity and D = Market value of debt = Book value of equity
- Total market value (V) = E + D = 3B + B = 4B (where B is book value of equity)
- Weight of equity (W_e) = E / V = 3B / 4B = 0.75
- Weight of debt (W_d) = D / V = B / 4B = 0.25

Step 2: Calculate Correct WACC

- WACC = $W_e \times K_e + W_d \times K_d = 0.75 \times 12\% + 0.25 \times 6\% = 10.5\%$

Step 3: Calculate Correct Firm Value

- Firm value (V_0) = $FCFF_1$ / (WACC - g) = ₹2 crores / (0.105 - 0.05) = ₹ 36.36 crores

Conclusion

The correct valuation of BDM Ltd. is ₹ 36.36 crores. This figure is notably lower than the initial valuation of ₹ 50 crores provided by the analyst, who incorrectly relied on book values rather than market

values in the Weighted Average Cost of Capital (WACC) calculation. This discrepancy underscores the critical importance of using accurate market value weights when determining the value of a company, especially in strategic acquisitions like that of BDM Ltd. by DPL. The revised valuation provides a more realistic assessment, aligning with DPL's commitment to prudent financial management and informed decision-making during the acquisition process.

2.8 Section 240 of the Companies Act, 2013 states that notwithstanding anything in any other law for the time being in force, the liability in respect of offences committed under this Act by the officers in default, of the transferor company prior to its merger, amalgamation or acquisition shall continue after such merger, amalgamation or acquisition.

In the given case, Mr. Ashok, who was a key figure in BDM Ltd. before the company's amalgamation with DPL, is under scrutiny for actions that reportedly breached corporate regulations. The offenses, which include several violations of the Companies Act, were committed prior to the completion of the amalgamation. However, Mr. Ashok is attempting to distance himself from the legal consequences of these actions, arguing that since the offenses occurred before the amalgamation, he should not be held liable for any resulting penalties or punishments.

With reference to the above quoted section and the given case, the contention of Mr. Ashok is not correct since the liability in respect of offences committed under the Companies Act 2013 by the officers in default, of the transferor company prior to its merger, amalgamation or acquisition shall continue after such merger, amalgamation or acquisition.

CASE STUDY 3

Company Overview

Founded by Manish Jha and Keyur Vasai in 2006, Doormato is a public company whose shares are traded on a stock exchange. The company has developed a multifaceted business model within the food and restaurant industry, incorporating various revenue streams and services. Despite facing stiff competition both domestically and internationally, Doormato's ability to adapt, diversify its services, and leverage

technology has secured its strong position in the market. The company utilizes AI across multiple aspects of its operations.

Understanding that trust is paramount in the online food delivery business, Doormato has introduced the "food soldier" program. This initiative goes beyond data security, involving representatives who personally interact with restaurant partners to address concerns and foster positive relationships. Additionally, Doormato's user-driven review system creates a sense of community where users can share their food experiences and engage in creating stories. This engagement builds a community centered around shared culinary experiences, encouraging users to return to the platform and explore new restaurants.

Doormato's user base of over 20 million, which includes both restaurants and individual consumers, fuels a powerful network effect. The platform's value to each user increases as more participants join. For users, a vast pool of restaurants ensures a diverse selection of cuisines, while restaurants benefit from a wider customer reach and increased order volume. This cycle of growth and satisfaction enhances user loyalty and enables Doormato to negotiate better deals with restaurants, offering more competitive options to customers.

Revenue Streams

One of Doormato's primary revenue streams is the commission it charges restaurants for each order placed through its food delivery service. When a user orders food from a restaurant via the Doormato app, the restaurant pays a percentage of the order value as a commission to Doormato. This commission varies but is typically in the range of 15% to 25% of the order amount, depending on the restaurant's agreement with Doormato. Also, Doormato earns a commission from the restaurant for each successful reservation made through its platform.

In addition to the commission received from restaurants, Doormato imposes delivery fees charged directly to customers at checkout. These fees are not a flat rate, but rather a calculated amount that considers several factors to ensure fairness and affordability. The primary determinant is the order value itself. Larger orders, with a higher order subtotal, typically incur proportionally lower delivery fees compared to smaller orders.

Furthermore, Doormato recognizes the impact of location on delivery logistics. Delivery fees may be slightly higher in areas with greater geographical spread or limited delivery personnel, reflecting the additional cost of fulfilling the order. This dynamic pricing approach allows Doormato to maintain a competitive edge while ensuring the sustainability of their extensive delivery network. Ultimately, transparency in delivery fee calculation fosters trust with customers, who can make informed decisions based on their order details and location.

Beyond connecting users with restaurants, Doormato offers a robust suite of advertising and promotional services designed to enhance a restaurant's presence on the platform. Restaurants can leverage these services to gain a competitive edge by featuring their listings more prominently in search results, running targeted ad campaigns to specific customer segments, and offering enticing deals to attract new patrons. This focus on restaurant visibility translates into a significant revenue stream for Doormato, as restaurants are willing to invest in promoting themselves to the platform's vast user base.

One such customer-centric initiative by Doormato is the voucher program. Here, users can purchase a voucher for ₹1,000 that unlocks a value of ₹1,200 worth of food credit. This effectively provides a 20% discount on any food items from participating restaurants within a 3-month validity period. This program incentivizes users to explore new restaurants and potentially spend more due to the increased credit value, ultimately benefiting both Doormato and participating restaurants by increasing order volume.

Furthermore, many restaurants listed on Doormato operate their own loyalty programs, allowing customers to earn points on each order. These points can then be redeemed for future discounts, further enhancing customer loyalty and encouraging repeat business. Imagine a scenario where a customer has accumulated enough points through Doormato's loyalty program with a specific restaurant to earn ₹ 200 discount on their next order. If their current bill amount at the same restaurant is ₹900, they can seamlessly combine the discount with the Doormato voucher, effectively reducing their final bill to just ₹700. This combination of promotional efforts by Doormato and individual restaurants creates a win-win situation for all parties involved – users enjoy significant savings,

restaurants attract new customers and retain existing ones, and Doormato benefits from increased platform activity.

Doormato Gold is a subscription-based loyalty program that offers members exclusive discounts and perks at partner restaurants. Users pay a subscription fee to access these benefits. While a portion of this fee is passed on to the partner restaurants, Doormato retains a share, contributing to its revenue. Subscription to Doormato Silver provides customers with a printed copy a high-quality magazine focusing on food and health, that will be delivered to their doorstep each month and access to the magazine's online content.

Strategic Expansion Consideration

In lieu of strategic expansion, management wants to place an agenda in its coming meeting to acquire a company **"African Eats"**. African Eats is an online food ordering and delivery platform. The meals are delivered by couriers using various methods, including cars, scooters, bikes, or on foot. It is operational in over 60 cities in 5 African countries. These countries use common currency 'African Rand'. In 2023, the company was sued for antitrust price manipulation, from forcing restaurants to charge the same price for delivery as for dine-in if the restaurant wants to be listed on the African Eats app, along with charging fees of 13–40% of revenue. The exchange rate for the African Rands is extremely volatile. The rate of inflation in this African Region is presently 10% a year. Inflation in India is currently 5% a year. Management of Doormato expects these rates likely to continue for the foreseeable future. Estimated projected cashflows, in real terms, for the first three years of the project are as follows:

	Year–0	Year–1	Year–2	Year-3
Cash flows in Indian ₹ (000)	-1,00,000	-3,00,000	-4,00,000	-50,000
Cash flows in African Rand (000)	-4,00,000	+5,00,000	+6,50,000	+7,50,000

Doormato assumes the year 3 nominal cash flows will continue to be earned each year indefinitely. It evaluates all investments using nominal cash flows and a nominal discounting rate. The present exchange rate is African Rand 4.5 to ₹ 1.

Audit Considerations

JS & Associates are at a crossroads regarding their audit approach for Doormato for the financial year ending March 31st, 2024. Historically, they have identified management override of controls and revenue recognition as significant risks. However, their audits in the past 2 financial years yielded clean reports with no issues detected in these areas.

This absence of recent red flags presents a dilemma. On one hand, maintaining a conservative approach suggests continuing to assess these areas as significant risks. This ensures a thorough examination and mitigates the chance of missing potential issues that could arise due to unforeseen circumstances or changes within Doormato.

On the other hand, consistently clean reports raise the question of continued significance. JS & Associates might consider performing a more focused assessment or reducing the emphasis on these risks while still acknowledging their potential impact. This could streamline the audit process without compromising effectiveness.

As part of a risk-based audit approach, JS & Associates focus on areas with a higher likelihood of material misstatement.

ANNEXURE

The New Age

Food Presentation Discrepancy Sparks Trust Concerns Among Customers on Doormato App



In a recent development, Shyam, a loyal customer of Doormato, has raised concerns about the disparity between the food images displayed on the Doormato app and the actual dishes served by restaurants. This issue, which has been described as a breach of trust between customers and restaurants, has sparked a broader discussion on the authenticity of food presentation in online food delivery services.

Ravi, a prominent figure in the culinary industry, expressed his concerns over the misleading nature of these images. He pointed out that while the images were initially intended to enhance the visual appeal of dishes and attract customers, they have inadvertently led to dissatisfaction and disappointment when the reality does not match expectations. Doormato is yet to comment on the issue, but industry experts believe that addressing this concern promptly will be crucial in preserving customer loyalty and trust.

I. Multiple Choice Questions

3.1 Assuming Doormato is planning to acquire hyper-local delivery company “Kit-Kit’, which enables to order grocery, fruits & vegetables, and other daily essential products with intention to diversify in this field. “Kit-Kit’ has over the period 10 million registered users throughout the country. However, “Kit-Kit’ does not have any intention to sell the customer list. Should this customer list be recorded as an intangible in such a business combination?

(a) Such customer list should be recorded as an intangible in a business combination as “Kit-Kit’ has the ability to transfer it.

(b) Such customer list should not be recorded as an intangible in a business combination as “Kit-Kit’ has not the ability to transfer it.

(c) Such customer list should be recorded as an intangible in a business combination as it gives rise to legal or contractual right.

(d) The recording of such customer list depends upon the business combination agreement between both the companies.

3.2 As part of a risk-based audit approach, JS & Associates focus on areas with a higher likelihood of material misstatement. Which of the following statements best describes the concept of significant auditor attention in the context of scenario given in the case study?

(a) JS & Associates will spend an equal amount of time reviewing all sections of Doormato's financial statements

(b) JS & Associates will prioritize audit procedures for areas with a lower risk of material misstatement.

(c) JS & Associates will design the audit procedures based on their assessment of risks that could potentially cause errors in the financial statements of Doormato.

(d) JS & Associates will rely solely on past audit results to determine the scope of their procedures.

3.3 Under GST, what is the time of supply and taxable value for Doormato at the time of voucher purchase of ₹ 1,000?

(a) Time of supply is date of issue of the voucher and taxable value is ₹ 1,000 (face value of voucher)

(b) Time of supply is date of issue of the voucher and taxable value is ₹ 1,200 (credit value of voucher)

(c) Time of supply is date of redemption of the voucher and taxable value is ₹ 1,200 (credit value of voucher)

(d) Time of supply is date of redemption of the voucher and taxable value is ₹ 1,000 (face value of voucher)

3.4 Considering the above scenario, which of the following statements is MOST ACCURATE regarding the dynamic QR code and invoice for ₹ 900 meal order, where a customer has accumulated enough points through Doormato's loyalty program with a specific restaurant to earn a ₹ 200 discount on their next order?

(a) The QR code will only display the final payable amount of ₹ 700 (after ₹ 200 discount). No mention of the original bill amount or discount details will be shown.

(b) The QR code will display the final payable amount of ₹ 700 and reference of ₹ 200 discount on a separate invoice, but the invoice won't mention the original bill amount.

(c) The QR code will display the final payable amount of ₹ 700. The invoice will mention the original bill amount of ₹ 900, ₹ 200 discount details (including reference to the loyalty program), and the final payable amount.

(d) The QR code cannot be generated in this scenario because the discount reduces the taxable value, requiring a revised invoice without the discount information.

3.5 According to Ind AS 115 - Revenue from Contracts with Customers, how many performance obligations does Doormato have relating to the Doormato Silver subscription?

(a) One performance obligation: The overall subscription service.

(b) Two performance obligations: The delivery of the printed magazine and providing access to online content.

(c) Three performance obligations: Delivery of the printed magazine, access to online content, and customer support.

(d) No performance obligations, as the services are not distinct.

II. Descriptive Questions

3.6 To place agenda regarding Strategic Acquisition African Eats before the board it was required to:

i. To CALCULATE the net present value (NPV) of the proposed investment. While the nominal discount rate used by Doormato is 8% but considering risk nature of the project, 6% risk premium is required to be considered. Notes - (1) Taxation to be ignored in this calculation (2) PVF and exchange rates to be considered upto four decimal (3) final calculations to be rounded off the whole number.

ii. EVALUATE the external environment for Doormato's strategic acquisition of African Eats, considering the non-financial factors. (HINT- How do political, economic, social, cultural, technological, legal, and ethical factors influence the success of this investment? What strategies should Doormato implement to address these challenges and ensure a successful acquisition?)

3.7. i. ADVISE on how to address and maintain customer trust and relationships in response to the concerns raised in the recent newspaper article.

ii. How can blockchain technology be APPLIED by Doormato and finance professionals in the following areas:

(a) Supply chain operations

(b) Audit processes

(c) Managing sensitive customer data

3.8. DRAW a Business Model Canvas of Doormato.

ANSWERS TO THE CASE STUDY 3

I. Answers to the Multiple Choice Questions

3.1 (a) Such customer list should be recorded as an intangible in a business combination as "Kit-Kit' has the ability to transfer it.

Reason: In this situation, the customer database does not give rise to legal or contractual right. Accordingly, the assessment of its separability will be assessed. The database can be useful to other players and "Kit-Kit' has the ability to transfer this to them. Accordingly, the intention not to transfer will not affect the assessment whether to record this as an intangible or not. Hence customer list should be recorded as an intangible in a business combination.

3.2 (c) JS & Associates will design the audit procedures based on their assessment of risks that could potentially cause errors in the financial statements of Doormato.

Reason: As per SA 701

The concept of significant auditor attention recognizes that an audit is risk-based and focuses on identifying and assessing the risks of material misstatement of the financial statements, designing and performing audit procedures responsive to those risks, and obtaining audit evidence that is sufficient and appropriate to provide a basis for the auditor's opinion. Options (a), (b), and (d) do not accurately represent the emphasis on risk assessment in a significant auditor attention approach.

3.3 (c) Time of supply is date of redemption of the voucher and taxable value is ₹ 1,200 (credit value of voucher)

Reason: As per section 13(4) of the CGST Act, 2017, the time of supply of vouchers is -

Date of issue of the voucher, if the supply that it covers is identifiable, at that point, or

Date of redemption of the voucher in other case

Here, food ordering credit voucher can be used on any food items and so the time of supply of vouchers is the date of redemption of the voucher.

In terms of rule 32(6) of the CGST Rules, 2017 relating to valuation, the value of a voucher is equal to the money value of the goods or services redeemable against it. Therefore, though the voucher is sold for ₹1,000, its value is ₹1,200

3.4 (c) The QR code will display the final payable amount of ₹ 700. The invoice will mention the original bill amount of ₹ 900, ₹ 200 discount details (including reference to the loyalty program), and the final payable amount.

Reason: When the part-payment for any supply has already been received from the customer/ recipient, either in advance or by adjustment (e.g. using a voucher, discount coupon etc.), before the dynamic QR Code is generated, then the dynamic QR code may provide only the remaining amount payable by the customer/ recipient against "invoice value". The details of total invoice value, along with details/ cross reference of the part payment/ advance/ adjustment done, and the remaining amount to be paid, should be provided on the invoice.

Accordingly, the QR code will display the final payable amount of ₹ 700. The invoice will mention the original bill amount of ₹ 900, ₹ 200 discount details (including reference to the loyalty program), and the final payable amount.

3.5 (b) Two performance obligations: The delivery of the printed magazine and providing access to online content.

Reason: Under **Ind AS 115 - Revenue from Contracts with Customers**, a performance obligation is defined as a promise to transfer a distinct good or service to the customer.

A good or service that is promised to a customer is distinct if both of the following criteria are met:

(a) the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer; and

(b) the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract.

In the case of the Doormato Silver subscription:

- **Monthly delivery of the printed magazine** is a distinct good, as customers can benefit from the magazine independently each month.
- **Access to the online content** is a distinct service that provides additional value separate from the physical magazine.

Since both the printed magazine and online content meet the criteria for being distinct goods or services, they are considered separate performance obligations under **Ind AS 115**.

Therefore, Doormato has **two performance obligations** related to the Doormato Silver subscription:

1. Delivery of the printed magazine.
2. Providing access to the online content.

This approach ensures that each distinct service is accounted for and recognized in line with the benefits provided to the customer.

II. Answers to the Descriptive Questions

3.6 (i) Calculation of NPV

Year	0	1	2	3
Inflation factor in India	1.00	1.05	1.1025	1.1576
Inflation factor in Africa	1.00	1.10	1.21	1.331
Exchange Rate (as per IRP)	4.50	4.7143	4.9388	5.1741
Cash Flows in ₹'000				
Real	-1,00,000	-3,00,000	-4,00,000	-50,000
Nominal (1)	**-1,00,000**	**-3,15,000**	**-4,41,000**	**-57,880**
Cash Flows in African Rand'000				
Real	-4,00,000	5,00,000	6,50,000	7,50,000
Nominal	-4,00,000	5,50,000	7,86,500	9,98,250
In Indian ₹'000 (2)	**-88,889**	**1,16,666**	**1,59,249**	**1,92,932**
Net Cash Flow in ₹'000 (1) + (2)	**-1,88,889**	**-1,98,334**	**-2,81,751**	**1,35,052**
PVF@14%	1	0.8772	0.7695	0.6750
PV	**-1,88,889**	**-1,73,979**	**-2,16,807**	**91,160**

NPV of Terminal value = 1,35,052/ 0.14 × 0.6750 = 6,51,144 (₹ '000)

NPV of 3 years = -4,88,515 (₹ '000)

Total NPV of the Project = -4,88,515 (₹ '000) + 6,51,144 (₹ '000) = 1,62,629 (₹ '000)

Note: There can be a slight difference in exchange rate in 3rd year. Accordingly, the final answer may be slightly varied.

(ii) Recommendations for Strategic Consideration

When evaluating the strategic acquisition of African Eats, Doormato must consider a range of non-financial factors that could impact the success of the investment. These factors are crucial for understanding the broader implications of the acquisition beyond the immediate financial metrics. Below is an elaboration on each relevant point:

Political Environment

The political environment in the countries where African Eats operates can significantly influence the business's operational stability. Doormato needs to *assess the risk of political instability, such as changes in government, civil unrest, or policy shifts that could disrupt business operations*.

In countries with unstable governments, there is a *higher risk of unexpected regulatory changes*. A thorough understanding of the regulatory landscape in each country is necessary. This includes the ease of doing business, regulatory requirements for foreign investments, and potential barriers to entry. *Uncertain or frequently changing regulations can create challenges in compliance and increase operational costs*.

Economic Factors

The extreme volatility of the exchange rate in the African country where African Eats operates poses a significant risk. Currency fluctuations can erode profit margins, especially when revenues are earned in a depreciating currency while costs or financial obligations are in a stronger currency. Doormato should consider hedging strategies or other financial instruments to mitigate this risk.

With an inflation rate of 10% in the African Region and 5% in India, Doormato must assess how these rates will affect both the costs and revenues of African Eats. High inflation can lead to increased operational costs, reduce consumer purchasing power, and impact demand for services. The company should explore pricing strategies that account for inflation while maintaining competitiveness.

Moreover, evaluating the broader economic environment in the target countries is essential. This includes assessing the potential for economic growth, consumer spending trends, and the overall demand for online food delivery services. Economic downturns or recessions could reduce disposable income, impacting the frequency and volume of orders on the platform.

Social and Cultural Factors

Understanding the cultural distinctions in each of the countries where African Eats operates is crucial for customer engagement and brand positioning. Doormato must ensure that its marketing strategies, customer service, and overall business approach are culturally sensitive and resonate with local consumers. Misunderstanding cultural norms or preferences can lead to reputational damage and lost market opportunities. Language plays a significant role in communication with customers, partners, and employees. Ensuring that the platform is available in local languages and that customer support can effectively communicate in these languages is critical for building trust and loyalty.

Doormato should also consider how social trends, such as consumer attitudes toward food delivery, and health consciousness, might vary across the region. Understanding these trends can help tailor the service offerings to meet local preferences and increase market penetration.

Technological Considerations

African Eats' business model relies heavily on technology, including mobile apps, online payment systems, and delivery logistics. Doormato needs to evaluate the technological infrastructure in each country, such as internet penetration rates, mobile network coverage, and availability of reliable payment

gateways. Poor infrastructure can lead to operational inefficiencies and limit the platform's reach.

The success of an online food delivery platform depends on the willingness of consumers and restaurants to adopt and use the technology. Doormato should assess the level of technological adoption among the target population, including the prevalence of smartphones and familiarity with online ordering systems.

Moreover, operating in multiple countries exposes African Eats to a range of cybersecurity threats. Doormato should ensure robust cybersecurity measures are in place to protect sensitive data, including customer information and payment details. Data breaches or cyber-attacks could severely damage the platform's reputation and lead to legal liabilities.

Legal and Regulatory Environment

Each country may have its own set of laws and regulations governing online businesses, consumer protection, labor practices, and competition. Doormato must ensure that African Eats complies with all relevant legal requirements in each market. Failure to comply could result in fines, legal disputes, or even the suspension of operations.

African Eats was previously sued for antitrust price manipulation, which highlights the importance of understanding and complying with competition laws in the target countries. Doormato needs to evaluate the legal implications of continuing or altering African Eats' pricing strategies and business practices to avoid future legal challenges.

In addition, Doormato should also consider the local labor laws, including those related to employment contracts, worker rights, and minimum wage requirements. Given that African Eats employs delivery personnel in various countries, it is crucial to ensure compliance with these laws to avoid legal disputes and maintain a positive relationship with the workforce.

Moreover, some African countries may impose restrictions on the repatriation of profits, making it challenging to transfer earnings back to India. Doormato needs to understand the legal and regulatory framework governing profit repatriation and plan accordingly. This might involve exploring alternative methods of moving funds, such as reinvesting profits locally or negotiating

special agreements with the host government. While taxation has been ignored in the NPV calculation, it is important to consider the local tax laws for repatriating profits. Double taxation treaties, withholding taxes, and local tax rates could all affect the net returns from the investment.

Ethical Considerations

In some African countries, issues like child labor or poor working conditions may be prevalent. Doormato must ensure that African Eats adheres to ethical labor practices, not only to comply with international standards but also to maintain its corporate social responsibility (CSR) image. Moreover, this can help mitigate the risk of reputational damage. Engaging in CSR activities that benefit local communities can enhance Doormato's brand image and foster goodwill among consumers. This could include initiatives such as supporting local farmers, reducing the environmental impact of delivery operations, or contributing to social causes in the regions where African Eats operates.

Conclusion

While the financial analysis indicates a positive NPV for the acquisition, the strategic benefits of entering the African market may still be compelling. However, Doormato must carefully consider the non-financial risks and challenges associated with this acquisition. Conducting thorough due diligence, addressing potential legal, cultural, and ethical issues, and implementing robust risk management strategies will be critical for the success of the acquisition. A comprehensive understanding of the external environment will enable Doormato to make an informed decision and potentially mitigate the risks associated with expanding into the African market.

3.7 (i) This situation serves as a reminder that while marketing and presentation are vital, maintaining customer trust through authenticity is equally, if not more, important. Customers expect honesty, and when there is a significant difference between what they see and what they receive, it can damage the relationship between the restaurant and the customer. The company should plan to actively remove AI-generated images (if any) from menus by as earliest as possible and should also reject new submissions of such images. CEO should urge restaurant partners and Doormato's internal marketing team to

cease using AI-generated images for promotional purposes. Instead, Doormato's should provide free real food photography service and encourage restaurants to avail this service. This service may be given at no profit or loss basis. In addition, Doormato should give a clarification like "At Doormato, we use various forms of AI, to make our workflows efficient. However, one place where we strongly discourage the use of AI is images for dishes in restaurant menus. AI-generated food/dish images are misleading" This decision highlights the growing concern surrounding the ethical implications, particularly in contexts where authenticity and accuracy are paramount. Doormato's proactive approach aims to restore trust and ensure a more transparent experience for its users.

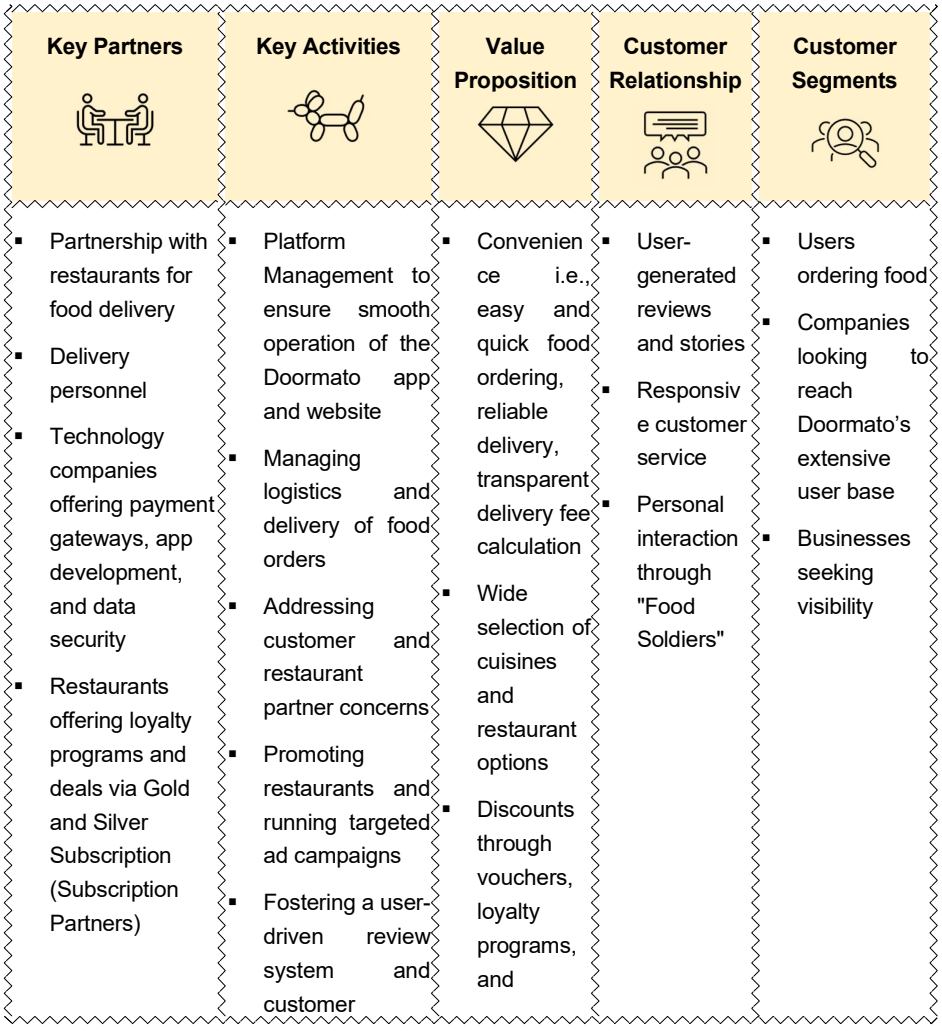
(ii) (a) With blockchain technology, Doormato can create a decentralized ledger that records every step of the supply chain process, from picking food package from the restaurants to final product delivery. Each transaction is securely recorded on the blockchain, providing real-time visibility and transparency to all stakeholders involved. The finance professional can easily access the blockchain to verify the authenticity and accuracy of transactions, ensuring compliance with regulatory requirements and building trust with customers, investors, and auditors.

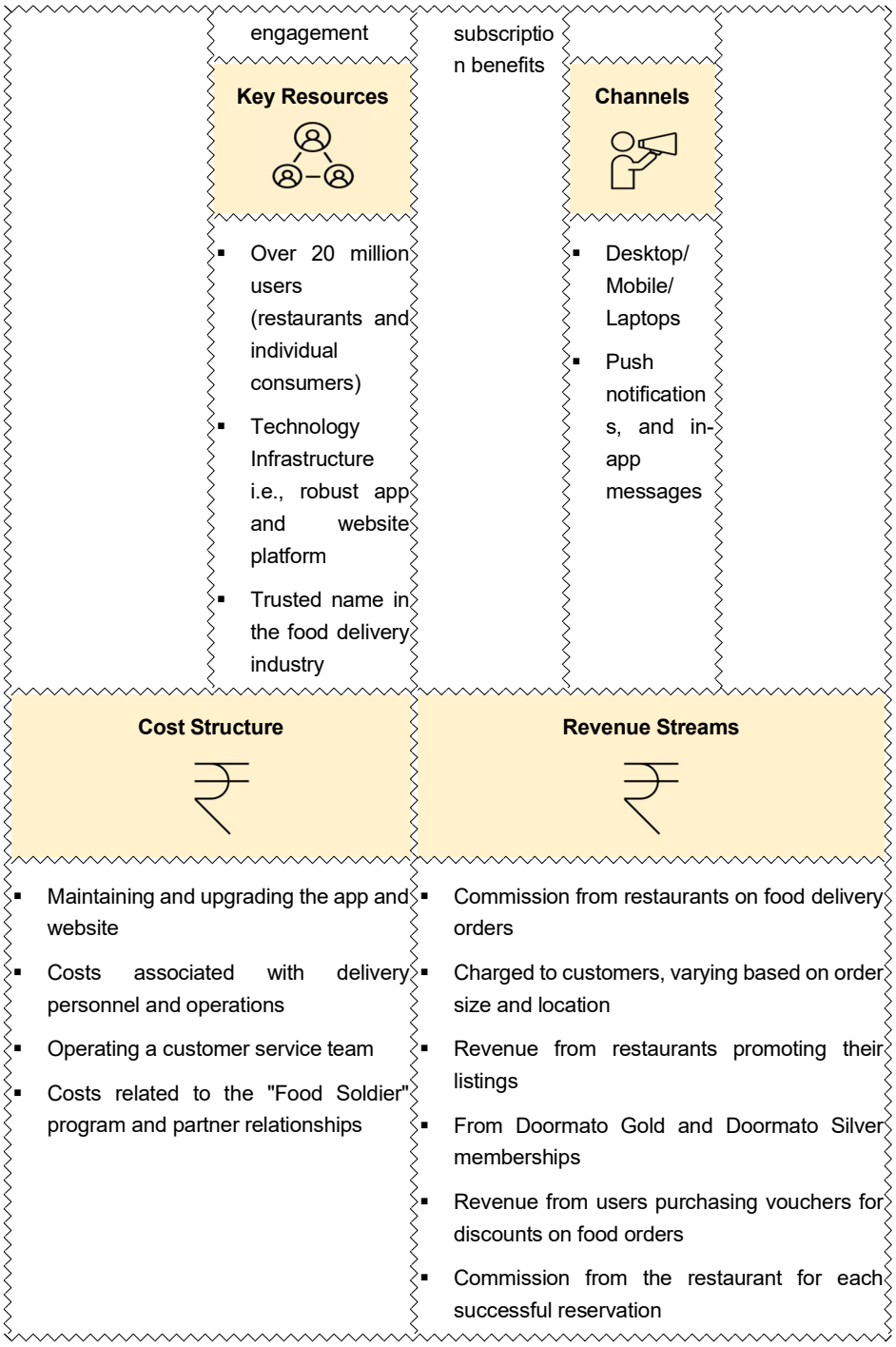
(b) Traditionally, audits involve manually reviewing numerous financial transactions and reconciling data from different sources, which can be time-consuming and prone to errors. However, with blockchain technology, the e-commerce platform, Doormato, can implement a blockchain-based payment system that automatically records and timestamps every transaction. During the audit process, the finance professional can access the blockchain ledger to instantly verify transaction details, reconcile data, and ensure compliance with accounting standards and regulatory guidelines. This streamlined approach improves audit efficiency, reduces the risk of human error, and enhances the accuracy of financial reporting.

(c) By utilizing blockchain technology, Doormato can implement a secure and encrypted blockchain network to

store and share customer data. The finance professional can ensure the integrity and security of the data by leveraging blockchain's cryptographic algorithms and consensus mechanisms. This eliminates the risk of unauthorized access, data tampering, or data loss. With blockchain, the finance professional can confidently handle customer data, knowing that it is protected by a robust and transparent system, enhancing data privacy, and maintaining the trust of customers and regulatory bodies.

3.8 Business Model Canvas of Doormato




engagement
subscriptio n benefits
Key Resources
Channels
Over 20 million users (restaurants and individual consumers)
Technology Infrastructure i.e., robust app and website platform
Trusted name in the food delivery industry
Desktop/ Mobile/ Laptops
Push notification s, and in-app messages
Cost Structure
Revenue Streams
Maintaining and upgrading the app and website
Costs associated with delivery personnel and operations
Operating a customer service team
Costs related to the "Food Soldier" program and partner relationships
Commission from restaurants on food delivery orders
Charged to customers, varying based on order size and location
Revenue from restaurants promoting their listings
From Doormato Gold and Doormato Silver memberships
Revenue from users purchasing vouchers for discounts on food orders
Commission from the restaurant for each successful reservation

This Business Model Canvas outlines how Doormato operates, generates revenue, and delivers value to its customers and partners. The company's focus on trust, community, and variety, along with its multifaceted business model, positions it strongly in the competitive food delivery and restaurant aggregation market.

CASE STUDY 4

Emergence of Green Entrepreneurship

India's remarkable economic progress, marked by its position as the fastest-growing major economy, has been driven by a comprehensive strategy that emphasizes entrepreneurship and self-employment. The government's policies have fostered an environment conducive to starting businesses, particularly in emerging sectors like sustainability and renewable energy.

Amidst this entrepreneurial renaissance, the story of Priya and Arjun stands out. Both graduates from a prestigious engineering college, they shared a passion for environmental conservation and a desire to contribute to a greener future. Inspired by the government's initiatives to promote clean technologies and the growing global demand for eco-friendly solutions, Priya and Arjun decided to take the entrepreneurial leap. In 2021, they founded EcoTech Innovations Pvt. Ltd., a company dedicated to developing cutting-edge technologies for sustainable energy generation and waste management.

Guided by their **mission *"to pioneer innovative, sustainable technologies that drive environmental conservation, enhance waste management efficiency, and contribute to a cleaner future for all,"*** and their **vision "*to become a global leader in sustainable energy and waste management solutions"*** Priya and Arjun aimed to build their company that not only thrived in the market but also made a significant positive impact on the environment.

Growth, Expansion, and Strategic Partnerships

The waste management industry, where EcoTech operates, is on a robust growth trajectory, projected to exceed $500 billion globally by 2025. With urbanization and industrialization surging, the industry is witnessing rapid advancements in AI, IoT, and recycling technologies. In 2023, the global waste management market was valued at approximately $380 billion, highlighting significant expansion potential. Government

regulations and initiatives, such as the European Union's Circular Economy Action Plan and India's Swachh Bharat Mission, are driving improvements in waste desegregation, recycling rates, and plastic waste reduction. Public-private partnerships are also increasing, enhancing infrastructure and innovation. This sector is becoming crucial in achieving global environmental sustainability and resource efficiency goals.

Initially, Priya and Arjun were the sole shareholders and directors of EcoTech Innovations Pvt. Ltd. However, as the business grew, they brought on board their friend, a sustainability expert, Rahul, as a co-shareholder with a 15% stake. Priya and Arjun each retained 42.5% ownership. To navigate the complexities of finance, accounting, and compliance, they appointed their trusted friend Megha as the Chief Financial Officer (CFO).

As EcoTech experienced rapid growth and expansion, the need for a new state-of-the-art head office became evident. The construction of the new office building commenced on 1st September, 2023 and continued until 31st December 2023. At the beginning of September month, the directly attributable expenditure on this asset was ₹ 1,00,000. However, as construction progressed, the costs increased, with the company incurring ₹ 2,50,000 in each of the subsequent months from October to December 2023. Although EcoTech Innovations Pvt. Ltd. did not take any specific borrowings to finance the construction, the company incurred finance costs on its general borrowings during the construction period. To meet its capital requirements, EcoTech issued 10% debentures with a face value of ₹ 20 lakhs during the year.

Additionally, the company had an existing overdraft facility of ₹ 5,00,000, which was increased to ₹ 7,50,000 in December, 2023. The interest rate on the overdraft was 15% until 1st October, 2023, after which it was increased to 16%. Megha was tasked with ensuring proper accounting treatment and compliance with the relevant accounting standards for the capitalization of borrowing costs related to the construction of the new head office building during the construction period. Her expertise in finance was crucial in navigating these complex financial decisions.

In addition to its domestic operations, EcoTech also exports its eco-friendly solutions to European and Middle Eastern countries. During FY 2023-24, EcoTech Innovations Pvt. Ltd. acquired a 55% equity stake in GreenWave Ltd., a company engaged in manufacturing and selling a product named ‘EcoClean.’ The fair value of GreenWave Ltd.’s identifiable net assets as per the relevant Ind AS is ₹ 12 crore, and its

paid up share capital is ₹ 10.50 crore. For the acquistion, EcoTech paid a cash consideration of ₹ 10 crore, with the fair value of the non-controlling interest on the date of acquisition being ₹ 3 crore. GreenWave Ltd. appointed Mr. Rahul as its whole-time company secretary and Mr. Arjun as its managing director, positions they also held at EcoTech Innovations Pvt. Ltd. On 25th August, 2023, GreenWave Ltd. sold two of its machines to Mr. Arjun out of which one machinery was exchanged for a vehicle owned by Mr. Arjun, and the other was sold for cash consideration.

Compliance Challenges

EcoTech Innovations Pvt. Ltd. has been self-funded since its inception, relying on the founders' expertise, determination, and the support of environmentally conscious investors. The company's innovative solutions have garnered recognition both domestically and internationally, exemplifying the potential of Indian entrepreneurship to drive sustainable development while contributing to the nation's economic growth. To further expand their operations and accommodate their growing team, EcoTech Innovations Pvt. Ltd. entered into a lease agreement for a new office space in April 2023. The lease term is 10 years, with a single lease payment of ₹ 1,00,000 payable at the beginning of each year. According to the lease contract, the annual lease payments will increase by the rate of SOFR. Megha highlighted the importance of accurately measuring the lease liability as per the relevant Ind AS. This financial decision would play a crucial role in ensuring accurate financial reporting and compliance, which are vital for the company's continued success and growth.

Priya and Arjun understood the intricate interplay between inflation, project costs, demand patterns, and financing implications. They realized the importance of conducting comprehensive project appraisals that account for these factors. They appreciated Megha's expertise in guiding them through the complexities of project evaluation, ensuring that EcoTech Innovations Pvt. Ltd. made well-informed decisions about its future growth strategies. During a board meeting in April 2023, Megha informed the directors that the company's financial statements for the current year would be prepared in accordance with the Indian Accounting Standards (Ind AS). Priya and Arjun expressed their growing concerns to Megha about the lack of progress following the company's recent

decentralization efforts. Despite granting greater autonomy to local managers in hopes of boosting performance and fostering innovation, the anticipated improvements had not materialized. They sought Megha's expertise and strategic insight on how to navigate this complex situation, improve local managers' engagement, and ensure the company's growth trajectory remained on track. Megha's role as CFO and her understanding of the company's financial health and strategic goals positioned her uniquely to provide the guidance needed to overcome this significant hurdle.

EcoTech Innovations Pvt. Ltd. had an outstanding interest liability of ₹ 1 crore towards a loan payable to GreenFinance Ltd., a public financial institution that had been a crucial supporter in the early stages of the company's growth. To manage this liability more effectively and preserve cash flow, EcoTech issued debentures of ₹ 275 lakhs carrying an interest of 7.5% to GreenFinance Ltd. in lieu of the outstanding interest as well as for the outstanding loan payable to it. This strategic move allowed the company to defer the immediate cash outflow and focus on its operational needs. While computing the profits and gains of business for the
A.Y. 2024-25, EcoTech Innovations Pvt. Ltd. deducted the said interest, anticipating it would be a legitimate business expense. However, the Assessing Officer rejected the deduction of interest on the loan claimed by EcoTech, creating an unexpected challenge for the financial team.

Additionally, EcoTech achieved a gross profit of ₹ 18 crores and incurred indirect expenses of ₹ 4 crores for the financial year, reflecting its robust financial performance despite the complexities in interest liability management. During the annual audit of EcoTech Innovations Pvt. Ltd., the tax consultant raised a concern regarding a notice issued by the Commissioner of Income-tax. The Commissioner had initially issued a notice to revise the order passed by an Assessing Officer under section 143. While the proceedings were ongoing before the Commissioner, based on material gathered during a survey under section 133A after the issuance of the first notice, the Commissioner of Income-tax issued a second notice with different contents from the first notice. The tax consultant questioned whether the action of the Commissioner in issuing the second notice with divergent contents was justified.

Finally, in a separate event, EcoTech Innovations Pvt. Ltd. imported a machine from France for ₹ 180 lakh during March 2023, paying all duties of customs. Due to a technical manufacturing defect, the machine was sent back to the supplier for repairs in October 2023 and re-imported in August 2024 without any re-manufacturing or reprocessing, after repairs. Since the machine was under warranty, the repairs were carried out free of cost, although the fair cost of repairs would have been ₹ 5 lakh (excluding the cost of material, which was ₹ 10 lakh). The actual insurance and freight charges (to and from) were ₹ 5 lakh (₹ 2.50 lakh each way). The ownership of the machinery did not change during this period.

I. Multiple Choice Questions

4.1 Referring to the lease transaction in the case study, at the date of commencement of the lease, SOFR is 2 percent and the interest rate implicit in the lease is 5 percent. The amount of lease liability to be recognized initially will be -

(a) ₹ 8,60,789

(b) ₹ 8,80,889

(c) ₹ 8,75,645

(d) ₹ 8,74,889

4.2 Comment upon the validity of the action of the Assessing Officer on rejecting the deduction of interest on loan claimed by EcoTech.

(a) The interest so converted into debentures shall be deemed as actual payment but would not be allowed as deduction while computing its profits and gains of business for A.Y.2024-25. The action of the Assessing Officer is correct.

(b) The interest so converted into debentures shall be deemed as actual payment, and hence, would be allowed as deduction but while computing 'Income from other sources' for A.Y.2024-25 even though the liability to pay is deferred to a future date. Thus, the action of the Assessing Officer is partially correct, as the said interest though not allowed while computing profits and gains of business but would be allowed as deduction while computing 'Income from other sources'.

(c) The interest so converted into debentures shall not be deemed as actual payment, and hence, would not be allowed as

deduction while computing its profits and gains of business for A.Y.2024-25. The action of the Assessing Officer is correct.

(d) The interest so converted into debentures shall be deemed as actual payment as in the given case loan is provided by a public financial institution and hence, would be allowed as deduction while computing its profits and gains of business for A.Y.2024-25. The action of the Assessing Officer is not correct.

4.3 Whether there was any statutory requirement for GreenWave Ltd. to appoint a whole-time Company Secretary (CS) and whether Mr. Rahul was eligible to be appointed as its whole-time Company Secretary?

(a) No, as its paid-up capital had not exceeded the prescribed limit and also Mr. Rahul was not eligible as he was already holding office as a whole-time CS in one other company i.e. EcoTech Innovations Pvt. Ltd.

(b) Yes, as its paid-up capital had exceeded the prescribed limit and also
Mr. Rahul was eligible to be appointed as its whole-time CS in GreenWave Ltd. as it was the subsidiary company of EcoTech Innovations Pvt. Ltd.

(c) Yes, as its paid-up capital had exceeded the prescribed limit. However,
Mr. Rahul was not eligible to be appointed as its whole-time CS as he was already holding office as a whole-time CS in one other company i.e. EcoTech Innovations Pvt. Ltd.

(d) No, as its paid-up capital had not exceeded the prescribed limit. However, Mr. Rahul was eligible to be appointed as its whole-time CS as it was the subsidiary company of EcoTech Innovations Pvt. Ltd.

4.4 What will be the capitalization rate for construction period of four months for computation of borrowing cost in accordance with the relevant Ind AS related to the construction of a new office building?

(a) 3.987%

(b) 3.756%

(c) 2.607%

(d) 3.188%

4.5 What shall be the value of goodwill for EcoTech Innovations Pvt. Ltd. on the acquisition of 55% shares of GreenWave Ltd. as per the fair value method and proportionate share method?

(a) ₹ 1,00,00,000, ₹ 7,40,00,000

(b) ₹ 2,00,00,000, ₹ 3,40,00,000

(c) There is no goodwill arising but there is a gain on bargain purchase of ₹ 1,00,00,000

(d) ₹ 1,00,00,000, ₹ 3,40,00,000

II. Descriptive Questions

4.6 EcoTech Innovations Pvt. Ltd. owns 30% of the share capital in GreenTech Solutions Pvt. Ltd. and has the ability to exercise significant influence over it. GreenTech Solutions Pvt. Ltd. holds the following investments:

70% of the share capital of its subsidiary, SustainCo Ltd., and 30% of the share capital of EcoEnergy Pvt. Ltd., with the ability to exercise significant influence. EcoTech Innovations Pvt. Ltd. transacts with SustainCo Ltd. and EcoEnergy Pvt. Ltd.

Should EcoTech Innovations Pvt. Ltd. disclose these transactions as related party transactions in its separate financial statements? Also, explain the disclosure of such transactions in the financial statements of SustainCo Ltd. and EcoEnergy Pvt. Ltd. as related party transactions.

4.7 Priya and Arjun, the founders of EcoTech Innovations Pvt. Ltd., were concerned about the potential implications of this notice on the company's tax compliance. They sought guidance from their Chief Financial Officer, Megha. Accordingly, examine whether the action of the Commissioner is justified as to the second notice.

4.8 You are required to advice EcoTech Innovations Pvt. Ltd. on the concessions (if any) available for importation of the machinery after repairs, also state the conditions to be satisfied for availing such concession. Also compute the customs duty and integrated tax payable (if any) on the re-import of the machine after repairs. The rate of basic customs duty is 15% and integrated tax is 12%. Ignore Agriculture infrastructure and development cess.

4.9 Whether there were any restrictions for GreenWave Ltd. to sell its machinery to Mr. Arjun in exchange for a vehicle and if yes, then what legal requirements would have been followed by it?

ANSWERS TO THE CASE STUDY 4

I. Answers to the Multiple Choice Questions

4.1 (b) ₹ 8,80,889

Reason: As per Ind AS 116, the lease payments should initially be measured using SOFR of 2 percent as at the commencement date. Therefore, while measuring the lease liability, each year the payments will be increased by 2 per cent, as follows:

Year	Lease Payment	Discount Factor	PV of lease payments (₹)
1	1,00,000	1	1,00,000
2	1,02,000	0.952	97,104
3	1,04,040	0.907	94,364
4	1,06,121	0.864	91,689
5	1,08,243	0.823	89,084
6	1,10,408	0.784	86,560
7	1,12,616	0.746	84,012
8	1,14,869	0.711	81,672
9	1,17,166	0.677	79,321
10	1,19,509	0.645	77,083
			8,80,889

Therefore, the lease liability will initially be measured at ₹ 8,80,889.

4.2 (c) The interest so converted into debentures shall not be deemed as actual payment, and hence, would not be allowed as deduction while computing its profits and gains of business for A.Y.2024-25. The action of the Assessing Officer is correct.

Reason: The interest so converted into debentures and not actually paid shall not be deemed as actual payment, and

hence, would not be allowed as deduction while computing its profits and gains of business for A.Y. 2024-25. The action of the Assessing Officer is correct.

As per section 43B, interest payable by the assessee on interest on loan from a public financial institution is allowable as deduction only in the year in which such interest is actually paid by the assessee. The proviso to section 43B permits deduction if such sum is paid on or before the due date of filing of return under section 139(1) in respect of the previous year in which the liability to pay such sum was incurred. Explanation 3C to section 43B clarifies that if any sum payable by the assessee as interest on any such loan is converted into a loan or borrowing or debenture or any other instrument by which the liability to pay is deferred to a future date, the interest so converted shall not be deemed as actual payment, and hence, would not be allowed as deduction. In this case, since EcoTech has converted the interest of ₹ 1 crore payable to GreenFinance Ltd. on loan borrowed from it, the interest so converted into debentures shall not be deemed as actual payment, and hence, would not be allowed as deduction while computing its profits and gains of business for A.Y.2024-25. Accordingly, the action of the Assessing Officer in rejecting the deduction of interest on the loan claimed by EcoTech while computing its profits and gains of business for A.Y. 2024-25, is correct.

4.3 (b) Yes, as its paid-up capital had exceeded the prescribed limit and also Mr. Rahul was eligible to be appointed as its whole-time CS in GreenWave Ltd. as it was the subsidiary company of EcoTech Innovations Pvt. Ltd.

Reason: Requirement of Company Secretary in certain other companies Section 203 read with Rule 8 and Rule 8A of Companies (Appointment and Managerial Personnel) Rules 2014, as amended provides that every–

Listed company or

Public company having paid up share capital ₹ 10 crore or more
or

Private company having paid up share capital of ₹ 10 crore or more shall have a Whole time Company Secretary.

Bar on multiple appointments- A whole-time key managerial personnel shall not hold office in more than one company at the same time except in its subsidiary company. [Section 203(3)]

4.4 (c) 2.607%

Reason: Since the entity has only general borrowing, hence first step will be to compute the capitalisation rate. The capitalisation rate of the general borrowings during the period of construction is calculated as follows-

Particulars	**Amount (in ₹)**
Finance cost on ₹ 275 lakhs 7.5% debentures during September-December 2023	6,87,500
Finance cost on ₹ 20 lakhs 10% debentures during September-December 2023	66,667
Interest @15% on overdraft of ₹ 5,00,000 in September 2023	6,250
Interest @16% on overdraft of ₹5,00,000 in October and November 2023	13,333
Interest @16% on overdraft of ₹ 7,50,000 in December 2023	10,000
Total finance cost during September-December 2023	7,83,750

Weighted average borrowings during period

= [(2,75,00,000 × 4) + (20,00,000 × 4) + (5,00,000 × 3) +(7,50,000 × 1)]/4

= ₹ 3,00,62,500

Capitalisation Rate for 4 months period = Total finance costs during the construction period/ Weighted average borrowing cost during the construction period

= 7,83,750 /3,00,62,500

= 2.607%

4.5 (d) ₹ 1,00,00,000, ₹ 3,40,00,000

Reason:

Fair Value Method	Amount (in ₹)
Fair value of cash consideration transferred	10,00,00,000
Fair value of non-controlling interest	3,00,00,000
	13,00,00,000
Less: Value of subsidiary's identifiable net assets as per Ind AS 103	12,00,00,000
Goodwill	**1,00,00,000**

Proportionate Share Method	Amount (in ₹)
Fair value of cash consideration transferred	10,00,00,000
Proportional share of non-controlling interest in the net identifiable assets of acquiree (12,00,00,000 x 45%)	5,40,00,000
	15,40,00,000
Less: Value of subsidiary's identifiable net assets as per Ind AS 103	12,00,00,000
Goodwill	**3,40,00,000**

II. Answers to the Descriptive Questions

4.6 Disclosure by EcoTech Innovations Pvt. Ltd.: Under Ind AS 24, "Related Party Disclosures," related parties are defined as entities or individuals that have the ability to exercise control or significant influence over the reporting entity, or vice versa. In this scenario, EcoTech Innovations Pvt. Ltd. owns 30% of the share capital in GreenTech Solutions Pvt. Ltd., which gives it the ability to exercise significant influence over GreenTech. This significant influence extends to the subsidiaries of GreenTech as well, making SustainCo Ltd. a related party to EcoTech Innovations Pvt. Ltd. because SustainCo Ltd. is a subsidiary of GreenTech Solutions Pvt. Ltd. Therefore, any transactions between EcoTech Innovations Pvt. Ltd. and SustainCo Ltd. are considered related party transactions and must be disclosed in EcoTech Innovations Pvt. Ltd.'s separate financial statements.

Disclosure of Transactions with EcoEnergy Pvt. Ltd.: Although GreenTech Solutions Pvt. Ltd. holds 30% of the share capital in EcoEnergy Pvt. Ltd. and has significant influence over it, EcoTech Innovations Pvt. Ltd. neither directly own any share capital in EcoEnergy Pvt. Ltd. nor it have significant influence or control over EcoEnergy Pvt. Ltd. Therefore, according to Ind AS 24, EcoEnergy Pvt. Ltd. is not considered a related party to EcoTech Innovations Pvt. Ltd. The mere fact that EcoTech Innovations Pvt. Ltd. transacts with EcoEnergy Pvt. Ltd. through its associate GreenTech Solutions Pvt. Ltd. does not establish a related party relationship under Ind AS 24. Consequently, EcoTech Innovations Pvt. Ltd. is not required to disclose transactions with EcoEnergy Pvt. Ltd. as related party transactions in its financial statements.

Disclosure by SustainCo Ltd.: SustainCo Ltd. is required to disclose its transactions with EcoTech Innovations Pvt. Ltd. in its financial statements. According to Ind AS, a related party relationship exists between SustainCo Ltd. and EcoTech Innovations Pvt. Ltd. because EcoTech Innovations Pvt. Ltd. has significant influence over GreenTech Solutions Pvt. Ltd., which is the parent company of SustainCo Ltd. This creates a relationship where EcoTech Innovations Pvt. Ltd. can influence the decisions of SustainCo Ltd., making it a related party. As a result, any transactions between SustainCo Ltd. and EcoTech Innovations Pvt. Ltd. must be disclosed in SustainCo Ltd.'s financial statements as related party transactions.

Disclosure by EcoEnergy Pvt. Ltd.: EcoEnergy Pvt. Ltd. is not required to disclose its transactions with EcoTech Innovations Pvt. Ltd. as related party transactions. Under Ind AS, for entities to be considered related parties, there must be a direct or indirect control, joint control, or significant influence. In this case, EcoTech Innovations Pvt. Ltd. does not exert control or significant influence over EcoEnergy Pvt. Ltd. through GreenTech Solutions Pvt. Ltd. Therefore, no related party relationship is established between EcoEnergy Pvt. Ltd. and EcoTech Innovations Pvt. Ltd. As a result, EcoEnergy Pvt. Ltd. does not need to disclose its transactions with EcoTech Innovations Pvt. Ltd. as related party transactions in its financial statements.

4.7 The action of the Commissioner in issuing the second notice is not justified. The term "record" has been defined in clause (b) of Explanation 1 to section 263(1). According to this definition "record"

shall include and shall be deemed always to have included all records relating to any proceeding under the Act available at the time of examination by the Commissioner. In other words, the information, material, report etc. which were not in existence at the time the assessment was made and came into existence afterwards can be taken into consideration by the Commissioner for the purpose of invoking his jurisdiction under section 263(1). However, at the same time, in view of the express provisions contained in clause (b) of the Explanation 1 to section 263(1), such information, material, report etc. can be relied upon by the Commissioner only if the same forms part of record when the action under section 263 is taken by the Commissioner.

Issuance of a notice under section 263 succeeds the examination of record by Commissioner. In the present case, the Commissioner initially issued a notice under section 263, after the examination of the record available before him. The subsequent second notice was on the basis of material collected under section 133A, which was totally unrelated and irrelevant to the issues sought to be revised in the first notice. Accordingly, the material on the basis of which the second notice was issued could not be said to be "record" available at the time of examination as emphasized in clause (b) of the Explanation 1 to section 263(1).

4.8 As per *Notification No. 45/2017 Cus. dated 30.06.2017*, duty payable on
re-importation of goods which had been exported for repairs abroad is the duty of customs which would be leviable if the value of re-imported goods after repairs were made up of the fair cost of repairs carried out including cost of materials used in repairs (whether such costs are actually incurred or not), insurance and freight charges, both ways. However, following conditions need to be satisfied for availing this concession:

(a) goods must be re-imported within 3 years, extendable by further 2 years, after their exportation;

(b) exported goods and the re-imported goods must be the same;

(c) ownership of the goods should not change.

Since all the conditions specified above are fulfilled in the given case, the customs duty payable on re-imported goods will be computed as under:

Particulars	₹
Value of goods re-imported after exports [Cost of materials ₹10 Lakh + fair cost of repairs ₹ 5 Lakh + actual insurance and freight ₹ 5 lakh]	20,00,000
Add: Basic Customs duty @ 15% …(A)	3,00,000
Add: Social Welfare Surcharge @ 10% on ₹ 3,00,000 …(B)	30,000
Value for computing integrated tax	23,30,000
Integrated tax @ 12% (₹ 23,30,000 x 12 %) - (C)	2,79,600
Customs Duty and integrated tax payable …[(A) + (B) + (C)]	**6,09,600**

4.9 According to Section 192(1) of the Companies Act, 2013, no company shall enter into an arrangement by which:

(a) A director of the company or its holding, subsidiary, or associate company, or a person connected with him, acquires or is to acquire assets for consideration other than cash from the company; or

(b) The company acquires or is to acquire assets for consideration other than cash from such director or person so connected.

The above restriction is relaxed under certain conditions. A company may enter into an arrangement involving non-cash transactions as stated above if prior approval for such arrangement is accorded by a resolution of the company in a general meeting. Furthermore, if the director or connected person is a director of its holding company, approval must also be obtained by passing a resolution in the general meeting of the holding company.

The notice for approval of the resolution in the general meeting issued by the company or holding company must include:

- The particulars of the arrangement.
- The value of the assets involved in such arrangement, duly calculated by a registered valuer.

In the given instance, GreenWave Ltd. entered into a non-cash transaction with its managing director, Mr. Arjun, by selling its machinery in exchange for a vehicle. To comply with Section 192(1) of the Companies Act, 2013, GreenWave Ltd. would have needed to:

Obtain prior approval for such an arrangement through a resolution in its general meeting.

Since Mr. Arjun is also a director of its holding company, EcoTech Innovations Pvt. Ltd., prior approval would also need to be obtained by passing a resolution in the general meeting of EcoTech Innovations Pvt. Ltd.

By following these legal requirements, GreenWave Ltd. and EcoTech Innovations Pvt. Ltd. would ensure compliance with the Companies Act, 2013, regarding non-cash transactions involving directors and connected persons.

CASE STUDY 5

A Ltd., an established player in the hospitality industry, oversees its subsidiary B Ltd., which specializes in the tourism sector, contributing to synergies between hospitality and tourism through interconnected services and offerings. In a strategic move to bolster its operational capabilities, A Ltd. undertook a significant expansion by purchasing a new building and pre-installed office furniture and fixtures from P Ltd., a well-known construction company that operates under two distinct divisions: commercial real estate and residential real estate, managed by Manager 1 and Manager 2 respectively.

A Ltd.'s purchase of the new building from P Ltd. marks a significant enhancement in its infrastructure, directly impacting its ability to deliver superior services in the hospitality sector. The integration of state-of-the-art facilities and high-quality furnishings ensures that A Ltd. can offer a first-rate experience to its clients, setting a benchmark in the industry. This strategic move also positions A Ltd. to better accommodate the growing demands and complexities of the modern businesses, which increasingly values seamless, high-quality service delivery.

Moreover, this also facilitates greater collaboration between A Ltd. and its subsidiary, B Ltd., fostering an ecosystem where both entities can thrive through mutual support and shared resources. For instance, the new building could also serve as a central hub for both managing operations and hosting client meetings, workshops, and corporate events, thereby enhancing the synergy between A Ltd.'s hospitality services and B Ltd.'s tourism offerings.

P Ltd. is recognized for its diversified portfolio, catering to a broad spectrum of clients. The commercial real estate division, under the leadership of Manager 1, focuses on developing and selling properties tailored for businesses, such as office spaces and commercial complexes. This division is renowned for its turnkey solutions, providing clients with ready-to-use spaces that are modern, functional, and well-equipped. The residential real estate division, managed by Manager 2, deals with housing projects ranging from high-rise apartments to luxury villas, emphasizing comfort, aesthetics, and community living.

P Ltd.'s ability to deliver such tailored real estate solutions stems from its robust relationships with suppliers like Q Ltd., whose high-quality materials are crucial for the construction and maintenance of premium properties. Their materials are pivotal in ensuring the structural integrity and aesthetic quality of buildings. This relationship highlights the importance of a reliable supply chain in maintaining the quality and reliability of real estate developments. P Ltd.'s strategic choice of materials ensures durability and aesthetic appeal, which are critical for properties serving the high expectations of the hospitality and tourism sectors. Q Ltd.'s commitment to quality and timely delivery helps P Ltd. maintain its reputation for reliability and excellence in the construction industry.

As A Ltd. continues to grow and adapt to the changing dynamics of these industries, the strategic foresight demonstrated in such acquisitions will be pivotal. By aligning its physical assets with its service goals, A Ltd. enhances its competitive edge and cements its reputation as a leader in providing comprehensive hospitality and tourism experiences. This strategic alignment not only benefits A Ltd. but also sets a standard for operational excellence and integration within the industry, ultimately leading to sustained growth and success in a competitive marketplace.

Overall, the interconnections between these companies exemplify a well-integrated supply chain and strategic business relationships that span different sectors, each contributing to the final delivery of quality real estate solutions tailored to the specific needs of industries such as hospitality and tourism.

The case centres around A Ltd., where a cashier committed fraud by absconding with the company's funds. The Chief Accountant of A Ltd. was unaware of the fraudulent activity until the audit had been completed. The audit, conducted in an unfocussed and haphazard manner, failed to

detect the fraud, which was only discovered by the Chief Accountant post-audit. An investigation later found that the auditor had not exercised proper skill and care.

Soon, another scandal follows. The Income-tax department collected documents from ABC Bank which revealed that B Ltd. had remitted substantial amounts abroad. The documents collected include Form 15CB issued by the Chartered Accountant, list of passengers, copy of their passports, date of travel and invoice raised by the foreign party. On enquiring from the passengers and verifying their passports, it is found that they did not travel abroad during the dates mentioned in the documents. Further, the passengers denied any sort of transactions with B Ltd. The department, therefore, concluded that the amounts were remitted abroad on the basis of false invoices and for wrong reasons, leading to FEMA violations and that the Form 15CB issued by the Chartered Accountant facilitated such violations. During the nine-month period in question, the chartered accountant had issued 150 certificates in Form 15CB approximately involving remittances of 40 crores in favour of B Ltd.

The Chartered Accountant submitted that he had issued Form 15CB based on invoices produced by the company and verifying the KYC documents of the signatory to the invoices. He however, failed to bring on record the invoices. He further submitted that since he was not the statutory auditor of the company, he did not examine the books of account before issuance of Form 15CB or conduct due diligence of its business activities. He had charged ₹ 4,000 per certificate. Mostly, the fee was collected in cash. Some part of the fee was credited to his bank account.

In the wake of such huge scandals, A Ltd. wants to know the provision for applicability to conduct secretarial audit as they never conducted secretarial audit thinking they don't have enough business transactions to consider these requirements earlier. Company provides you information: Paid-up Share Capital ₹ 45 crore, Turnover ₹ 170 crore and Outstanding Loans and Borrowings of ₹ 120 crore from banks.

A Ltd has decided to appoint Mr. Anurag as Chief Internal Auditor to lead the internal audit function for the Company. The CEO of the Company has asked the HR head to define the reporting structure of the Chief Internal Auditor, so that he can discharge his duties objectively.

Further, CEO is also sceptical regarding the provisions of the Companies Act, 2013, applicable with respect to the constitution of the audit committee, he accordingly discussed his understanding with you and asked him to rectify in case he is not correct. He told you that he has the following understanding with respect to the provisions applicable for Audit Committee.

- *Any senior member of the company having expertise of accounting and financial management can be appointed as the chairperson of the Audit Committee.*

As discussed earlier, P Ltd. procures its raw materials from Q Ltd., a supplier specializing in metals. P Ltd. has recently decided to invest in an Electronic Data Interchange system that will enable P Ltd. to automatically place orders with its major suppliers. Currently, P Ltd.'s purchasing department staff have to place orders using postal mails and telephone to the company's suppliers, which is slow and inefficient.

Q Ltd. began its operations in 1991, starting as a modest enterprise and gradually transforming into a key player in the metal supply sector. Over the years, it has become an essential resource for a variety of industries, now supporting more than twelve distinct sectors with its extensive range of metal products. These sectors include Wood & Panel Products Manufacturing, Hearth Products, Site Furnishings, and both Commercial and Residential Construction, among others. This diversity has not only broadened Q Ltd.'s market presence but has also enhanced its expertise in delivering tailored solutions across various fields.

The growth of Q Ltd. can largely be attributed to its unwavering commitment to its clientele. The company has always prioritized customer satisfaction, ensuring that each client receives personalized service and support tailored to their specific industry needs. This customer-centric approach has been pivotal in fostering strong, long-lasting relationships and in securing a loyal customer base. Moreover, Q Ltd. prides itself on its dedication to quality. Each product in their extensive catalogue is a testament to meticulous craftsmanship, designed to meet the highest industry standards.

Employing a team of experts, Q Ltd. ensures that each sector it serves is backed by professionals with deep knowledge and specialized skills. These experts not only understand the unique demands of their respective industries but are also equipped to advise and assist customers in selecting the best materials for their specific applications. This level of expertise is critical in industries where the quality and specifications of materials can significantly influence the overall success of a project.

The operational structure of Q Ltd. is divided into two main divisions: Division 'F' and Division 'G'. Division 'F' focuses on serving industrial and commercial construction needs, providing robust materials that are essential for large-scale construction projects. This division is known for its ability to supply large volumes of materials reliably and efficiently, thereby supporting some of the most demanding construction timelines and project specifications.

On the other hand, Division 'G' caters more to specialized industries like Hearth Products and Site Furnishings, offering bespoke solutions that often require a finer attention to detail and aesthetics. This division combines technical expertise with creative design, ensuring that even the most aesthetically driven projects benefit from the highest standards of structural integrity and material excellence.

Each division works as an investment centre separately. The salary of each divisional manager is ₹ 7,20,000 per annum with the addition of an annual performance-related bonus based on divisional return on investment (ROI). A minimum ROI of 12% p.a. is expected to be achieved by each divisional manager. If a manager only achieves the 12% target, he will not be rewarded with a bonus. However, for every whole 1% point above 12% which the division achieves for the year, a bonus equal to 3% of annual salary will be paid subject to a maximum bonus of 20% of annual salary. The figures belonging to the year ended 31 March 2024 are given in Annexure. During the financial year 2023-24, PAO, manager of Division 'G' invested ₹ 13.6 million in new equipment including an advanced cutting machine, which will increase productivity by 10% per annum. BAO, manager Of Division 'F', has made no investment during the year, even though its computer system needs updation. Division 'F's

manager has already delayed payments of its suppliers due to limited cash & bank balance although the cash balance at Division 'F' is still better than that of Division 'G'.

ANNEXURE

The News

A Ltd. Expands Infrastructure with Strategic Acquisition of State-of-the-Art Building from P Ltd.



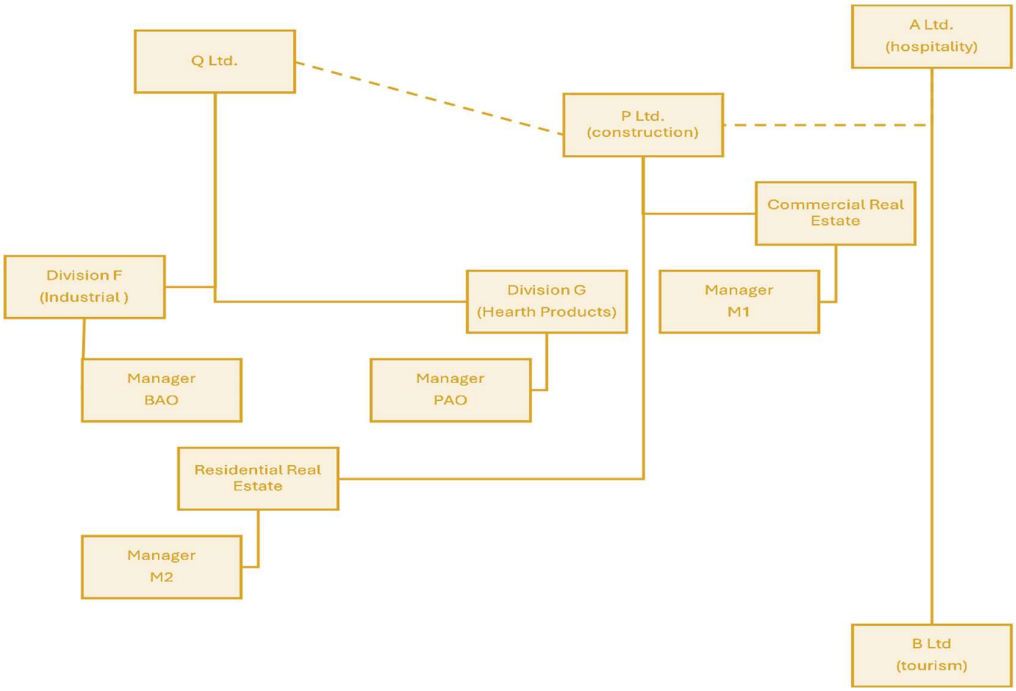
Gurugram, 20th April 2024 – In a major step towards enhancing its infrastructure and broadening its service offerings, A Ltd. has successfully acquired a state-of-the-art building from P Ltd. This acquisition is a key element of A Ltd.'s Future Ready Action Plan, aimed at revolutionizing its ability to deliver top-tier services in the hospitality sector and reinforcing its status as an industry leader.

The newly acquired building will house modern conference spaces, food labs, beverage research and development facilities, and versatile common areas. These cutting-edge additions will make conferences, virtual offices, and collaborative workspaces more accessible, affordable, and relevant, providing businesses with the tools they need to thrive in an increasingly competitive market.

With these advanced facilities and high-quality furnishings, A Ltd. is set to offer an unparalleled experience to its clients, setting new standards in the hospitality industry. This strategic investment not only reflects A Ltd.'s unwavering commitment to excellence in service delivery but also positions the company to meet the evolving demands of the modern business market.

As the complexities of the hospitality industry grow, A Ltd. is well-prepared to address the needs of today's businesses, who prioritize seamless and high-quality service. This expansion marks a pivotal moment in A Ltd.'s growth journey, underscoring its dedication to providing exceptional hospitality experiences and solidifying its future-ready approach.

Ecosystem



Financial Performance and Asset Overview of Division F and Division G

(₹ in '000)

	Division F	**Division G**
Revenue	30,000	17,500
Profit	5,200	4,000
Less: head office cost	(2,500)	(1,400)
Net profit	2,700	2,600
Non-current assets	19,500	30,000
Cash, inventory and trade receivables	5,000	6,500
Trade payable	6,200	2,800
Manager responsible	**BAO**	**PAO**

I. Multiple Choice Questions

5.1 Which of the following statements accurately characterize the situation of fraud committed by the cashier and the subsequent action:

(i) The auditor exhibited due diligence and careful conduct.

(ii) Clause (7) Of Part I of Second Schedule to the Chartered Accountants Act, 1949 and SA 240 are relevant in this situation

(iii) The auditor failed to plan and perform the audit with an attitude of professional skepticism

(iv) A Chartered Accountant in practice will be deemed to be guilty of professional misconduct based on clause (7) of Part II of the Second Schedule to the Chartered Accountants Act, 1949.

Options

(a) Only (iv)

(b) Both (ii) & (iv)

(c) Both (ii) & (iii)

(d) Both (i) & (iii)

5.2 The Board of director of A Ltd. appointed you to analyse the business of the organisation and advise whether they are contravening the provision of the Companies Act, 2013 with respect to Secretarial Audit.

(a) Yes, A Ltd. is required to conduct secretarial audit under the Companies Act, 2013 since A Ltd. crosses the threshold limit of outstanding loans and borrowings of rupees 100 crore or more.

(b) No, A Ltd. is not required to conduct secretarial audit under the Companies Act, 2013 since A Ltd. does not cross the threshold limit of outstanding loans and borrowings of rupees 200 crore or more.

(c) Yes, A Ltd. is required to conduct secretarial audit under the Companies Act, 2013 since A Ltd. crosses the threshold limit of Paid-up share capital of rupees 25 crore or more.

(d) Yes, A Ltd. is required to conduct secretarial audit under the Companies Act, 2013 since A Ltd. crosses the threshold limit of Turnover of rupees 100 crore or more.

5.3 Whether the understanding of CEO of A Ltd. is correct with respect to the appointment of chairperson of the Audit Committee?

(a) No, as only the company secretary of the company can be appointed as the chairperson of the Audit Committee.

(b) No, as the Chairperson of the Audit Committee shall be an independent director.

(c) Yes

(d) Partly correct as the chairperson should have expertise of accounting and financial management, however he should be a Chartered Accountant also.

5.4 With respect to the purchases made by A Ltd. from P Ltd., which of the following is correct regarding the GST liability?

(a) There will be no GST liability on purchase of building while Office furniture and fixtures will be liable to GST.

(b) There will be no GST liability on purchase of building and Office furniture and fixtures.

(c) There will be GST liability on both purchase of building and Office furniture and fixtures.

(d) There will be GST liability on purchase of building while Office furniture and fixtures will be not liable to GST.

5.5 Given the diverse functionalities of EDI systems in automating and standardizing transactional data across different departments and stakeholders, which specific area within P Ltd.'s value chain is expected to see the most significant improvement due to the implementation of this new EDI system?

(a) Infrastructure since it supports to perform primary activities.

(b) Inbound Logistic since it is directly involved in the transformation of a product or provisioning of a service.

(c) Procurement since it supports to perform primary activities.

(d) Outbound Logistic since it is directly involved in the transformation of a product or provisioning of a service.

II. Descriptive Questions

5.6 ADVISE the ideal reporting structure of the Chief Internal Auditor that HR head may propose to the Managing Director?

5.7 EXAMINE the ethical implications of the chartered accountant's issuance of Form 15CB without proper verification and due diligence in this case.

5.8 For each division of Q Ltd., COMPUTE, ROI for the year ending 31 March 2024. JUSTIFY the figures used in your calculation also COMPUTE bonus of each manager for the year ended 31 March 2024. DISCUSS whether ROI provides a justifiable basis for computing the bonuses of managers and the problems arising from its use at Q Ltd. for the year ended 31 March 2024.

5.9 DISCUSS how the strategic acquisition of a state-of-the-art building from P Ltd. will provide A Ltd. with a competitive advantage in the hospitality industry.

ANSWERS TO THE CASE STUDY 5

I. Answers to the Multiple Choice Questions

5.1 (c) Both (ii) & (iii).

Reason: In the given case, during the audit, auditor failed to discover the fraud. It is clearly given that investigation indicated that the auditor did not exercise reasonable skill and care and performed his work in a casual and unmethodical manner. According to the Clause (7) of Part I of Second Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he "does not exercise due diligence or is grossly negligent in the conduct of his professional duties". As per SA 240, "The auditor's responsibilities relating to fraud in an audit of financial

statements", it can be concluded that the auditor did not plan and perform the audit with an attitude of professional scepticism. Thus, having regard to this and a fraud has actually taken place during the year, committed by the absconding cashier, it is reasonable to think that prima facie there is a case against the auditor for gross negligence. From the facts given in the case and by applying Clause (7) of Part I of Second Schedule to the Chartered Accountants Act, 1949 and SA 240, it is clear that the auditor is guilty of professional misconduct.

5.2 (a) Yes, A Ltd. is required to conduct secretarial audit under the Companies Act, 2013 since A Ltd. crosses the threshold limit of outstanding loans and borrowings of rupees 100 crore or more.

Reason: In given case, A Ltd. crosses the threshold limit of outstanding loans and borrowings of rupees 100 crore or more for getting Secretarial Audit conducted. Accordingly, A Ltd. is required to conduct secretarial audit under the Companies Act, 2013.

[In terms of Rule 9(1) of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, for the purposes of sub-section (1) of section 204, Every Company having outstanding loans or borrowings from banks or public financial institutions of 100 crore rupees or more.]

5.3 (b) No, as the Chairperson of the Audit Committee shall be an independent director.

Reason: As per Regulation 18(1) of LODR Regulations, the chairperson of the Audit Committee shall be an independent director and he shall be present at Annual General Meeting to answer shareholder queries.

5.4 (a) There will be no GST liability on purchase of building while office furniture and fixtures will be liable to GST.

Reason: There will be no GST liability on purchase of building as sale of building is covered under Schedule III to the CGST Act, 2017. However, Office furniture and fixtures will be liable to GST.

5.5 (c) Procurement since it supports to perform primary activities.

Reason: The EDI system will improve the system for sourcing and purchasing materials. This is procurement. Note that inbound logistics refers to inventory management - not the purchasing of inventory itself.

II. Answers to the Descriptive Questions

5.6 HR Head needs to evaluate multiple options and identify the most suitable option in light of the relevant provisions, guidance and overall governance of the organization. HR head also needs to evaluate different options for his administrative reporting and various options for functional reporting of Chief Internal Auditor. The possible options to be considered and evaluated may include the Board of Directors, Audit Committee, Managing Director of the Company, Chief Executive Officer or Chief Financial Officer.

As per section 138 of the Companies Act 2013, the internal auditor shall either be a chartered accountant or a cost accountant (whether engaged in the practice or not), or such other professional as may be decided by the Board to conduct an internal audit of the functions and activities of the company.

As per the revised definition of the term 'Internal Audit' as per para 3 of the ICAI's Framework Governing Internal Audits, "Internal audit provides independent assurance on the effectiveness of internal controls and risk management processes to enhance governance and achieve organisational objectives".

The Internal Auditor shall be free from any undue influences which force him to deviate from the truth. This independence shall be not only in mind but also in appearance. Also, the internal auditor shall resist any undue pressure or interference in establishing the scope of the assignments or the manner in which these are conducted and reported, in case these deviate from set objectives.

As per the requirement of the above stated provision, Chief Internal Auditor needs to be independent of the operational activities and report of Audit Committee / Board of Directors to enjoy his true status of independent auditor. He may administratively report to CEO or Managing Director for his administrative reporting purpose or any other similar authority till the time it is approved by Board of Directors,

and it does not impact his independence to be able to perform his duties and report to audit committee / Board of Director independently.

5.7 Form 15CB is a certificate of an accountant wherein he certifies that he has examined the agreement between the remitter and the beneficiary requiring such remittance as well as the relevant documents and books of account required for ascertaining the nature of remittance and for determining the rate of deduction of tax at source. The chartered accountant certifying the form undertakes to have verified the agreement between the remitter and the beneficiary as well as the relevant documents and books of account to ascertain the nature of remittance and determine the rate of TDS. In this case, however, the chartered accountant mentioned that he had only verified KYC of signatory to invoice and the invoices thereof, He had not only failed to justify as to how verification of invoices was considered as sufficient compliance for certifying the forms but also failed to bring on record the said invoices. Thus, he failed to provide any basis on which he relied for issuing Form 15CB certificates to the company. On account of such failure, clauses (7) and (8) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 for failure to exercise due diligence in discharging his professional responsibilities and failure to obtain sufficient information may be invoked.

5.8 ROI

ROI expresses divisional profit as a percentage of the assets employed in the division. Assets employed can be defined as total divisional assets, assets controllable by the divisional manager, or net assets. ROI is a common measure and thus ideal for comparison across corporate divisions for companies of similar size and in similar sectors.

Division 'F'

controllable profit = ₹ 5,200K

Net Assets = ₹19,500k + ₹ 5,000K - ₹ 6,200K = ₹18,300K

ROI = 28.42%

Division 'G'

Controllable profit = ₹ 4,000K

Net Assets = ₹ 30,000K + ₹ 6,500K - ₹ 2,800K = ₹ 33,700K

ROI = 11.87%

Responsibility accounting advocates that managers performance shall be judged based upon how well he or she manages the items under his or her control, hence in computation Of ROI of division, controllable profit has been taken into consideration, because head Office costs are not controllable by divisional managers. Figures of non-current and current assets apart from the current liabilities have been taken into consideration as they are such items over which divisional managers have complete control.

Bonus

Bonus to be paid for each whole percentage point is ₹ 21,600 (₹ 7,20,000 x 3%). But there is ceiling limit as well, i.e. 20% of salary hence the maximum Bonus be ₹ 1,44,000 (₹ 7,20,000 x 20%).

Division 'F'

Divisional ROI is 28.42%, which results in 16 whole percentage points above the minimum required ROI of 12%. Hence the bonus according to each whole percent of excess ROI will be ₹ 3,45,600 (16 x ₹ 21,600). But there is upper cap of ₹ 1,44,000. Therefore, BAO be paid the bonus of ₹ 1,44,000.

Division ‘G'

Divisional ROI is 11.87%, since same is less than the minimum required ROI of 12%, hence PAO will not be rewarded with a bonus.

PAO will not receive any bonus since he has not earned any point above minimum percentage. This is due to the larger investment base on which the ROI figure has been computed. Total investment of Division ‘G’ is almost 1.84 times to that of Division ‘F’. The major reason behind this is that Division ‘G’ invested ₹ 13.6 million (₹ 13,600K) in new equipment during the year. Ignoring this investment of division D is just 0.91 times to that of division ‘F’ and net Investments would have been only ₹ 20,100K and the ROI for Division ‘G’ would have been 19.9% resulting in payment of a bonus ₹ 1,44,000 (7 × ₹ 21, 600 i.e. ₹ 1,51,200 but subject to upper cap of ₹ 1,44,000) rather than the nothing. So, PAO is being penalized for making investment decisions which are in the best interests of his division and company, because new investment enhance productivity which will support customer loyalty, dedication to customer services and quality, the CSFs for Q Ltd. It is very surprising that he decided to invest where he

knew that he would receive a lesser bonus subsequently. On the other hand, BAO has benefited from the fact that he has not invested in anything even though it was needed for computer system updation. This is an example of sub-optimal decision making.

Further, Division 'F''s trade payables are more than double those of Division 'G'. In part, one would expect this due to higher sales (almost 71% more than Division 'G') and low cash levels at Division 'F'. Higher trade payable leads to a reduction in net assets figures. The fact that Q Ltd. is rewarding BAO with a bonus, even though relationships with suppliers may be badly affected, is again a case of sub-optimal decision making.

If the profit margin (excluding head office cost) as percentage of sales is calculated, it comes to 17.33% (₹ 5,200 / ₹ 30,000) for division 'F' and 22.86% (₹ 4,000 / ₹ 17,500) for division 'G'. Therefore, it can be seen that division 'G' is performing better if capital employed is ignored. ROI is simply distorting the division 'G''s performance.

PAO might feel extremely disappointed by getting nothing and in the future, he may opt to postpone the investment to increase the bonus. Non- investing in new technology and equipment will mean that the Q Ltd. will not be kept updated with industry changes and its overall future competitiveness will be affected.

Briefly, the use of ROI results in sub-optimal decision making and a lack of goal congruence i.e. what is good for the managers is not necessarily good for the company too and vice versa. Hence ROI is not a justifiable basis to for computing the bonuses of divisional managers and also cause problem for Q Ltd.

5.9 The acquisition of the state-of-the-art building from P Ltd. offers A Ltd. several competitive advantages that can significantly enhance its position in the hospitality industry:

1. **Enhanced Service Offerings**: The new building will include modern conference spaces, food labs, beverage research and development facilities, and common areas. These additions allow A Ltd. to diversify its services, catering to a broader range of clients, including business travellers, corporate clients, and event organizers. By offering comprehensive, high-quality amenities, A Ltd. can attract new customer segments and retain existing ones, giving it a competitive edge over other players in the market.

2. **Differentiation in the Market**: The integration of cutting-edge facilities and high-quality furnishings sets A Ltd. apart from its competitors. In an industry where customer experience is paramount, the ability to provide state-of-the-art accommodations and services positions A Ltd. as a premium provider. This differentiation can lead to increased brand loyalty and the ability to command higher prices, further strengthening the company's market position.
3. **Future-Proofing and Innovation**: By incorporating food labs and beverage R&D facilities, A Ltd. is positioning itself as a leader in hospitality innovation. These facilities enable the company to experiment with new offerings and trends, staying ahead of market demands and setting trends rather than following them. This proactive approach to innovation helps A Ltd. maintain relevance in a rapidly evolving market.
4. **Operational Efficiency and Cost Savings**: The acquisition allows A Ltd. to consolidate its operations into a single, well-equipped location, leading to potential cost savings in terms of logistics, maintenance, and management. Efficient operations can improve profit margins and provide the financial flexibility needed to invest in further growth or offer competitive pricing.
5. **Attracting High-Profile Clients and Events**: The availability of modern conference spaces and advanced facilities makes A Ltd. an attractive venue for high-profile clients and large-scale events. Hosting such events not only generates significant revenue but also enhances the company's reputation, leading to positive word-of-mouth and further business opportunities.
6. **Scalability and Growth Opportunities**: With an expanded and upgraded infrastructure, A Ltd. can scale its operations more effectively. Whether it's expanding into new markets, launching new services, or increasing capacity, the acquisition provides the physical and operational foundation needed for sustained growth.
7. **Strategic Positioning**: As part of A Ltd.'s Future Ready Action Plan, this acquisition aligns with the company's long-term strategy of making conferences, virtual offices, and collaborative workspaces more accessible. This strategic alignment ensures that A Ltd. remains competitive in the face

of evolving market trends, particularly in response to the increasing demand for hybrid and virtual work environments.

In summary, the acquisition offers A Ltd. a comprehensive set of competitive advantages, from enhanced service offerings and market differentiation to innovation, operational efficiency, and strategic growth. These factors collectively strengthen A Ltd.'s market position, ensuring it remains a leader in the hospitality industry.

The suggested answers provided in these Case Studies includes a variety of potential solutions/ alternative points *where applicable*. This is intended to assist students by offering multiple perspectives and approaches to problem-solving.

CASE STUDY 6

The hospitality industry is a dynamic and multifaceted sector that plays a pivotal role in the global economy, encompassing a wide range of services including lodging, food and beverage, tourism, and event management. Known for its emphasis on customer service and experience, the industry thrives on creating memorable and personalized experiences for guests, whether through luxurious accommodations, exceptional dining, or unique recreational offerings. Despite challenges like high job mobility and evolving consumer preferences, the hospitality industry continues to innovate through advancements in technology, sustainability practices, and the adoption of ESG (Environmental, Social, and Governance) principles.

SarTaj Hotels Limited, the country's largest listed hospitality company, continues to demonstrate industry-leading growth with consistency and conviction. This is reflected in its exceptional financial and non-financial performance, including portfolio expansion and the scaling of new businesses. The company achieved this while aligning with its sustainability commitment and ESG initiative. These attributes accentuate its remarkable journey and the ways it creates value for all

stakeholders. SarTaj's consistency stems from its conviction in values and commitment to excellence.

With over 120 years of leadership in the industry, SarTaj Hotels is renowned for its exclusive properties, flawless service, and distinctive brands. These, all embodying the cherished notion of 'SarTajness,' create unforgettable experiences for guests. The company's deeply rooted values and rich legacy provide the confidence to re-imagine the future, enabling SarTaj to grow its ecosystem with greater speed, synergy, and success, bringing delight to its customers and driving enhanced value for all stakeholders. The company has evolved from a branded house into a House of Brands, offering a portfolio that includes luxury, upscale, lean luxe segments, and budget stays. This hospitality ecosystem is further strengthened by innovation and service excellence.

Hotel food service has historically been an integral part of the hotel business. Food service provide guests with food for consumption, business related functions, entertainment and celebrating events, and for some hotels food acts as an attraction in its own right.

Food service production

Food service production in hotels is primarily based on fresh produce. The perishable nature of this produce poses a challenge for hotels, further complicated by the presence of multiple food outlets and supply chain activities within each hotel. Additionally, hotel food is not designed to be stored for extended periods. Once prepared, it is expected to be consumed immediately or soon thereafter. The production of fresh food varies depending on the type of food services offered by individual hotels.

In terms of food sourcing, two main groups of food production are prevalent: 'push production' and 'pull production.'

Push production refers to services that have not been paid for in advance. These food services are available in restaurants, bars, guest rooms, or any other outlets where food can be ordered on demand. The number of these outlets varies depending on the hotel's designated food outlets and other areas where food may be served. Pull production caters to services such as functions, conferences, and other events that have been reserved in advance, with specific details provided (e.g., number of attendees, types of food required, and the venue). Payments for pull production services are typically made in advance, either partially or in full.

When it comes to food sourcing, push and pull productions have different conditions. Push production presents a greater challenge due to demand uncertainties. The data indicates that push production often involves a 'guessing game.' Accurately forecasting demand is considered difficult, and incorrect forecasts can result in either insufficient food to sell or excessive food wastage. In contrast, pull production is a more straightforward task in terms of planning for both the type and quantity of food to source.

Head chef as creator, memory and processer

The head chef plays a crucial role in hotel food service supply chains, being involved from the initial stage of product development through to the production stage. The extent to which the head chef influences supply chain activities depends on the configuration of the hotel's food service supply chain, which is shaped by the hotel's organizational characteristics. Head chefs are valuable resources of expertise and knowledge necessary for the smooth operation of the "production plant"—the kitchen—and all related activities. They function as creators, memory keepers, and processors who oversee production. Additionally, head chefs are responsible for key management areas beyond production, such as purchasing and inventory management.

The role of the head chef as a creator, stems from their responsibility for writing the menu. Menu writing is a form of product development, and in hotel food service, this development often appears to be intuitive. Several concepts emerged from the data that characterize the product development process. Menus not only serve as product offerings but also function as a tool to achieve target gross profit. Chefs view menu writing as more than just a job requirement; they think about it even outside working hours and see it as a creative task. Menus were frequently changed, with some chefs updating their menus daily. These changes were not only based on inventory availability or the chef's imagination but were also adjusted according to the price of raw materials. The frequency of menu changes is based on the chef's judgment rather than following a fixed schedule, as is common in many hotel companies.

Another critical management area, inventory management, is often referred to as a "guessing game." The head chef's knowledge and experience are crucial for managing the hotel's food supply. The head chef is the person who holds the information regarding inventory management. Common practices in hotels include maintaining a minimum stock level, also known as "reserve" or safety stock, and using

a "run out and replace" strategy, which involves replenishing stock when it runs low. Hotels that offer food service around the clock, such as restaurants, bars, and room service, must always have food in stock. If raw materials are unavailable in the market or deliveries are delayed, the hotels need to maintain a certain amount of food to ensure production continuity. Once the inventory drops below the level "guessed" by the head chef, an order is placed to restock to the minimum level. While some hotels can afford to use a "lean" strategy, which involves running out of stock and then ordering more, this approach is found in only a few hotels; most maintain a minimum stock level at all times.

Collaboration with suppliers

Suppliers not only play a crucial role in providing raw materials, but some SarTaj hotels also use their suppliers in menus and brochures to add value and differentiate their product offerings from competitors. It's interesting to note that SarTaj hotels maintain both traditional arm's-length relationships and long-term cooperative relationships with their suppliers.

SarTaj’s foodservice outlets leveraged fresh produce and their supplier partnerships as key selling points. The company highlighted collaborations with local suppliers and producers, as well as those offering specialty, high-quality ingredients, to showcase the uniqueness of its offerings. The strong relationships between chefs and suppliers were communicated effectively to customers, reinforcing SarTaj’s commitment to sourcing excellence and supporting local communities.

While lower raw material costs were constantly pursued, mainly for dry goods, prices were compared across various suppliers, with the cheapest options often being selected. SarTaj used a spreadsheet to track prices and select the best deals from different suppliers, which was seen as an advantage as the hotel was able to buy products at the lowest price.

In addition to making suppliers compete on price, SarTaj employed a "two-supplier strategy" to ensure the quality and price of certain products remained consistent. For instance, SarTaj had two suppliers for certain goods and alternated between them, as suppliers often raised prices or failed to maintain quality.

Use of technology

The exploitation of information technology in SarTaj group hotels is minimal, with a high degree of manual-based supply chain activities. Pen

and paper are the primary tools used for product planning. Although some SarTaj hotels use electronic data interchange with their suppliers, it is limited to basic operational tasks, such as placing orders. The hotels rarely retain their point-of-sale data, and sharing such information with suppliers is almost non-existent. Demand forecasting for business volume may be supported by computer programs, but forecasting demand variants remains a "guessing game".

Additionally, stock checking for raw materials is manually performed by physically counting inventory items. While some larger hotels utilize online ordering channels, most rely on telephone communication for placing orders. The widespread use of telephone ordering in the hotel sector is attributed to the shorter ordering time, suppliers' lead times, and the fact that telephoning offers two-way communication, allowing for discussion of product availability.

Even though some hotels employ computer-generated demand forecasting, it only helps estimate the overall volume of food required by hotel guests and other markets related to push production. However, uncertainty remains regarding demand for restaurant food, which is further complicated by variations in food requirements.

In house activities

While in-house production facilities offer many benefits, they also require significant investment in infrastructure, equipment, and skilled labour. Having a captive model makes it easier to implement design changes and customize products according to specific customer requirements. As a result, the company is less reliant on external suppliers and manufacturers, reducing risks associated with supply chain disruptions. Additionally, the company uses in-house teams of highly trained hotel staff for food preparation, which is a time- and labour-intensive process. However, rising staff costs and the increasing cost of high-volume food items are putting pressure on margins.

Several years ago, SarTaj appointed Mr. Ramakrishnan as the company secretary, recognizing his extensive experience in the hotel industry and expertise in handling regulatory compliance. At the time of his appointment, the company promised him an annual salary hike ranging between 15% and 25% of his total compensation package (CTC). Over the past few years, Mr. Ramakrishnan’s performance has been exceptional, consistently exceeding expectations and contributing significantly to the company's operational success, particularly in navigating complex compliance matters. His expertise has been

instrumental in managing regulatory challenges and addressing cost pressures associated with labour.

During the audit planning meeting, the auditor was informed that the entity generates a substantial portion of its revenue through cash sales, with annual revenue amounting to ₹ 1,000 crores. Key managerial personnel and senior management often face intense pressure to meet or exceed financial targets set by investors or analysts, and their remuneration is based on achieving these performance targets. The internal auditor assessed the internal control system and did not observe any deficiencies in the revenue recognition process. Based on this assessment, the auditor concluded that revenue is not susceptible to fraud risk and, accordingly, did not associate any fraud risk with revenue in the audit strategy.

SarTaj has a policy of providing loans to employees at a 5% annual interest rate, with the loan amount to be repaid in five equal annual installments. The market rate of interest (not a Level 1 input) for comparable loans is 10% p.a. On April 1, 2024, an employee took out a loan of ₹ 10 lakhs from SarTaj, with an annual EMI of `2.31 lakhs. SarTaj recognized the financial asset at ₹ 10 lakhs on April 1, 2024, accrued interest at 5% for the year, and received the EMI payment. The auditor raised concerns about the accounting treatment adopted by the entity for recognizing the financial assets.

The auditor also plans to communicate with the Audit Committee for several important reasons. Regular and open communication fosters a culture of transparency and builds trust between auditors and those charged with governance. This trust is crucial for the auditor to perform their duties without obstruction and for governance to have confidence in the audit process.

SarTaj has an overseas subsidiary, Black Pearl LLC. Under the FEMA (Overseas Investment) Regulations, 2022, SarTaj is required to file an Annual Performance Report (APR) with the Reserve Bank of India (RBI). The APR is part of the compliance framework to ensure that investments made by Indian entities abroad are monitored and reported accurately.

By adhering to these regulations and maintaining open communication with the Audit Committee, SarTaj Hotels fosters a culture of transparency, building trust between auditors and those charged with governance. This trust is essential for the smooth functioning of the audit process and ensures confidence in the financial oversight of the company.

ANNEXURE

Brand Portfolio of SarTaj

 **Kings Korner**	 **Hocus Pokus**	 **Stories**	 **Silverline**
India's strongest across sector, spacious suites with premium furnishings and state-of-the-art technology	Exclusive, agile upscale hotels	Simply better! Simple and functional design, focusing on practicality	Exclusive wellness experiences such as organic spa treatments or nature immersion activities
₹936 crores of revenue	*₹195 crores of revenue*	*₹48 crores of revenue*	*₹90 crores of revenue*
110 hotels	*96 hotels*	*91 hotels*	*8 hotels*
17,000 keys	*11,200 keys*	*9,000 keys*	*3,000 keys*

The SarTaj Hotels Limited

PARTICULARS OF EMPLOYEES

Information under Section 197 of the Companies Act, 2013 read with Rule 5(1) of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014

a. The ratio of the Remuneration of each Director to the median Remuneration of the employees of the Company for the financial year and percentage increase in Remuneration of each Director, Chief Executive Officer, Chief Financial Officer, or Manager, if any, in the financial year:

Name	% Increase of Remuneration in 2024 as compared to 2023	Ratio to median Remuneration
Non-Executive Directors		
Mr. Chandrasekaran T.@	-	-
Mr. Krishna Gupta	17%	21.95

Mr. Srinath Mehta	16%	18.96
Ms. Angel Gupta	15%	20.33
Mr. Sharad Aggarwal *	***	***
Mr. Ravi Gupta	32%	18.59
Executive Director		
Mr. Puneet Jaiswal – MD & CEO	28%	570.0
Chief Financial Officer		
Mr. Giridhar Krishnan – EVP & CFO	6%	-

*@As a policy, Mr. Chandrasekaran T., Chairman, has abstained from receiving commission from the Company. *Retired as Director w.e.f. May 22, 2023. ***Since the remuneration is only for part of the year (either in CY or PY), percentage increase in remuneration and the ratio of their remuneration to median remuneration is not comparable and hence not stated.*

b. The percentage increase in the median remuneration of employees in the past 6 months was 5.5%.

c. The number of employees as on March 31, 2024 was 5,756.

d. Average Percentile increase already made in the salaries of employees other than the Managerial Personnel in the last financial year and its comparison with the percentile increase in the managerial remuneration and justification thereof and point out if there are any exceptional circumstances for increase in the managerial remuneration:

- During FY 2023-24, the average percentage increase / (decrease) in salary of the Company's employees, excluding Key Managerial Personnel ('KMP') was 8.8%.
- During FY 2023-24, the average percentage increase / (decrease) in salary of the KMP was 42%.

e. It is affirmed that the Remuneration is as per the Remuneration policy for Directors, Key Managerial Personnel, and other employees adopted by the Company.

I. Multiple Choice Questions

6.1 Whether the engagement partner is correct in claiming the presumptive risk of revenue recognition?

(a) No. Risk of fraud risk exists in revenue. Remuneration based on achievement of performance targets can incentivize employees to manipulate revenue. Greater risks of fraud exist where a substantial portion of revenues are through cash sales.

(b) Yes. Risk of fraud risk does not exist since revenue is more than SEBI prescribed limit of ₹ 500 crores.

(c) Yes. Risk of fraud risk does not exist in revenue. Performance based service conditions are common in Indian industries. It does not necessarily lead to a fraud in revenue.

(d) Yes. Risk of fraud risk does not exist in revenue. Performance based service conditions and concentration of cash sales are common in hotel industries. These conditions do not necessarily lead to a fraud in revenue.

6.2 Should SarTaj obtain audited financial statements of Black Pearl LLC while filing its Annual Performance Report under FEMA (Overseas Investment) Regulations, 2022? Which is the MOST appropriate answer?

(a) Filing of Annual Performance Report can be based only on audited financial statements of the Black Pearl.

(b) Filing of Annual Performance Report can be based only on reviewed financial statements of the Black Pearl.

(c) Filing of Annual Performance Report should be based on unaudited financial statements since the laws of the host country do not provide for mandatory audit.

(d) Filing of Annual Performance Report should be based on audited financial statements of the Black Pearl since Black Pearl is controlled by SarTaj.

6.3 Whether giving of loans to employees is in accordance with the requirements of the Companies Act, 2013?

(a) The Company should have obtained special resolution before giving loans since section 185 of the Companies Act, 2013 require special resolution before giving loan to any person including employees. Section 186 of the Companies Act, 2013 permits charging concessional rate of interest for loans given to employees.

(b) Section 185 of the Companies Act, 2013 do not cover loans to employees (not being directors). Section 186 of the Companies Act, 2013 permits charging concessional rate of interest for loans given to employees. Accordingly, the employee loans are in accordance with the requirements of Companies Act, 2013.

(c) Section 185 of the Companies Act, 2013 do not cover loans to employees (not being managing or whole-time director).

Section 186 of the Companies Act, 2013 do not cover loans to any employees (director or otherwise). Accordingly, the employee loans are in accordance with the requirements of the Companies Act, 2013.

(d) The Company should have obtained special resolution before giving loans since section 185 of the Companies Act, 2013 require special resolution before giving loan to any person including employees. Charging of interest at concessional rate is specifically prohibited under Section 186 of the Companies Act, 2013.

6.4 Why has SarTaj Hotels opted for different brands such as Kings Korner, Hocus Pokus, Stories, and Silverline within its portfolio?

(a) To increase operational efficiency by standardizing services across all hotel brands

(b) To focus solely on high-end customers and luxury travellers

(c) To minimize investment in the food and hospitality sector

(d) To target different customer segments by offering a variety of experiences ranging from luxury to budget accommodations

6.5 Which of the following information is NOT in line as required under Section 197 of the Companies Act, 2013, read with Rule 5(1) of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014? Refer with the extract.

(i) The number of employees as on March 31, 2024

(ii) The percentage increase in the median remuneration of employees

(iii) The percentage increase in remuneration of each Director, if any, in the financial year

(iv) The percentage increase in remuneration of Company Secretary, if any, in the financial year

(v) The ratio of the remuneration of CFO to the median remuneration of the employees of the company for the financial year

(vi) Affirmation that the remuneration is as per the remuneration policy

Options

(a) i, ii, iii

(b) i ,ii, iv

(c) ii, iii ,iv

(d) iii, iv, vi

II. Descriptive Questions

6.7 RECOMMEND the correct accounting treatment (initial and subsequent) as per Ind AS 109 of the loans given to employees at concessional rate.

6.8 EVALUATE the supply chain of SarTaj, identifying its current weaknesses and recommendations to overcome them.

ANSWERS TO THE CASE STUDY 6

I. Answers to the Multiple Choice Questions

6.1 (a) **No.** Risk of fraud risk exists in revenue. Remuneration based on achievement of performance targets can incentivize employees to manipulate revenue. Greater risks of fraud exist where a substantial portion of revenues are through cash sales.

Reason: Paragraph 26 of SA 240 provide a presumption that there are risks of fraud in revenue recognition. Further paragraph A29 of SA 240 provide that there may be pressures or incentives on management to commit fraudulent financial reporting through inappropriate revenue recognition in the case of listed entities when, for example, performance is measured in terms of year-over-year revenue growth or profit. Similarly, for example, there may be greater risks of fraud in revenue recognition in the case of entities that generate a substantial portion of revenues through cash sales.

6.2 (d) Filing of Annual Performance Report should be based on audited financial statements of the Black Pearl since Black Pearl is controlled by SarTaj.

Reason: The Annual Performance Report should be based on audited financial statement of Foreign Entity. Under Form APR

relaxation is provided from audited financial statement if the Indian person does not have control and local laws of foreign entity do not require mandatory audit. Thus, it is important to note that audit shall be required where Indian resident has control even if host country does not mandate it.

6.3 (c) Section 185 of the Companies Act, 2013 do not cover loans to employees (not being managing or whole-time director). Section 186 of the Companies Act, 2013 do not cover loans to any employees (director or otherwise). Accordingly, the employee loans are in accordance with the requirements of the Companies Act, 2013

Reason: Section 185 inter alia covers loans given to directors and loans to "any person in whom any of the director of the company is interested". In the present case provisions of section 185 is not triggered since loans have neither been given to employees nor to "any person in whom any of the director of the company is interested" - as employees are not covered within this expression.

Section 186 inter alia provide that no loan should be given to any 'person' at a rate of interest lower than the prevailing yield of 1-year, 3-year, 5-year or 10-year Government Security closest to the tenor of the loan. Explanation to Section 186(2) specify that the expression "person" does not include any individual who is in the employment of the company. Thus, giving of loans to these employees are not covered under section 186 of the Companies Act, 2013.

6.4 (d) To target different customer segments by offering a variety of experiences ranging from luxury to budget accommodations.

Reason: To target different **customer segments** by offering a variety of experiences ranging from luxury to budget accommodations.

SarTaj Hotels has opted for different brands within its portfolio—such as Kings Korner, Hocus Pokus, Stories, and Silverline—to target **varied customer segments**. Each brand caters to a distinct market:

- **Kings Korner** focuses on a premium, upscale experience with a large hotel network

- **Hocus Pokus** targets agile, upscale hotel experiences for mid-range travellers
- **Stories** provides budget-friendly yet quality stays
- **Silverline** offers an exclusive, high-performance experience with fewer hotels and a niche market

By diversifying its brand portfolio, SarTaj can cater to a wider range of customers, from luxury travellers to budget-conscious guests, ensuring broader market coverage and maximizing business growth opportunities. This aligns with **Customer Segments** in the Business Model Canvas, where different brands serve distinct customer needs and preferences.

6.5 (b) i ,ii, iv

Reason:

i. The number of **permanent** employees, not all employees, on the rolls of the company as of March 31, 20X4 should be disclosed.

ii. The percentage increase in the median remuneration of employees should be provided for the entire **financial year**, not just based on 6 months.

iii. The percentage increase in remuneration of each Director is correctly disclosed.

iv. The percentage increase in remuneration of the **Company Secretary** should also be disclosed.

v. The ratio of the remuneration of the CFO to the median remuneration of employees is **not required** to be disclosed. Only the ratio of each Director's remuneration to the median remuneration of employees is required.

vi. Affirmation that the remuneration is in line with the remuneration policy is correctly disclosed.

The above explanation aligns with the disclosure requirements under Section 197 and Rule 5(1).

II. Answers to the Descriptive Questions

6.6 In the given case, SarTaj has provided loan at 5% p.a. whereas market rate of interest is 10% p.a. This represents that the loan is provided at

off-market terms. Hence, the loan will be recognized at a fair value. Transaction price of providing a loan is ₹ 10 lakhs. However, the fair value of loan is ₹ 8.76 lakhs as shown in table below: *₹ lakhs*

Year	Cash flow - ₹	PV @ 10%	PV - ₹
2024-2025	2.31	0.909	2.10
2025-2026	2.31	0.826	1.91
2026-2027	2.31	0.751	1.74
2027-2028	2.31	0.683	1.58
2028-2029	2.31	0.621	1.43
Total	**11.55**		**8.76**

The difference between transaction price and fair value is ₹ 1.24 lakhs (₹ 10 lakhs – ₹ 8.76 lakhs).

In the stated case, SarTaj has provided a loan of ₹10 lakhs having fair value of ₹ 8.76 lakhs, it reflects the benefit provided to employees. Also, SarTaj Ltd has to pay ₹ 1.24 lakhs excess amount which will be amortized over the period of loan.

In view of Para B5.1.2A of Ind AS 109, accounting treatment should be as follows:

Initial Recognition:

- Financial Asset at fair value of ₹ 8.76 lakhs
- Prepaid Staff Expenses ₹ 1.24 lakhs

Subsequent Recognition:

- Interest @10% p.a. will be accrued on the outstanding balance of financial asset every year till completion of the loan account.
- Prepaid staff expense to be amortized in Statement of Profit and Loss over the tenure of the loan.

6.7 Current Weaknesses in SarTaj Hotels' Supply Chain

Demand Forecasting and Knowledge Reliance on Head Chefs

The supply chain's heavy reliance on the head chef for demand forecasting presents significant risks. Demand forecasting, especially with respect to product variants and business volume, is not data-driven but relies on the chef's "common sense" and guesses based on factors such as the business cycle, location, and clientele.

Due to the lack of formal data tracking, there is an absence of historical trends or customer usage information to inform accurate forecasting.

High Job Mobility of Head Chefs and Knowledge Retention Issues

Head chefs tend to change jobs frequently, leading to a loss of key operational knowledge. This results in inefficiency when new chefs join and have to begin from scratch, employing trial and error to gauge inventory requirements, leading to inconsistencies and inefficiencies in food production.

Low Technology Adoption

Despite basic use of technology, such as the Internet in product planning, overall supply chain processes rely heavily on manual activities. Demand forecasting remains a guessing game, with little integration of technology to predict demand variants and optimize supply chain processes.

Manual inventory checks further hinder efficiency, as stock counts are done by physically counting items, which is prone to errors and inefficiencies.

Time-Consuming and Costly In-House Food Preparation

The in-house food preparation process requires significant time, labour, and capital investment. While it allows for customized food offerings, the high labour costs and fluctuating raw material prices put pressure on margins and overall profitability.

Recommendations to Overcome Challenges

Data-Driven Forecasting

SarTaj Hotels should implement a data-driven approach to demand forecasting. This can be achieved by collecting and storing information on past product offerings, sales history, customer preferences, and inventory levels at each hotel. Utilizing this data will enable the company to move from a “guessing game” approach to data-backed decision-making.

By analyzing historical trends and customer demand patterns, SarTaj can better align its inventory management practices with actual demand, reducing both food wastage and stockouts.

Improving Knowledge Retention

A *formalized knowledge management system* should be implemented to capture the operational knowledge of head chefs, including their approach to menu development, inventory management, and customer preferences. This will ensure that when a new chef is appointed, they can build on previous knowledge rather than starting from scratch.

This system could include *standardized documentation* of food supply chain procedures, customer preferences, and sales data that new chefs can easily access and use.

Increased Use of Technology in Supply Chain Processes

SarTaj should digitize its supply chain processes, *introducing an integrated platform* for data sharing between hotels and suppliers. This platform would facilitate online ordering, real-time inventory tracking, and automated demand forecasting.

By sharing data with suppliers, SarTaj can reduce lead times and ensure better coordination between supply and demand. This can also help implement a jointly managed inventory system, reducing the overall cost of inventory management throughout the supply chain.

Transitioning to digital tools for inventory checks, menu planning, and ordering will streamline operations and allow head chefs to *focus more on creative aspects of their role*, rather than manual administrative tasks.

Outsourcing Part of Food Preparation

SarTaj Hotels could consider *outsourcing certain aspects of food preparation, particularly for high-volume, standardized food items* such as bread, desserts, or frozen goods. This would allow SarTaj to reduce in-house labour costs and invest more in creating a distinctive, high-quality dining experience for items that require bespoke preparation.

By *outsourcing routine or labour-intensive processes*, the hotels can reduce costs, improve efficiency, and focus on enhancing the unique elements of their menu that differentiate their brand.

Supplier Collaboration and Dual-Sourcing Strategy

SarTaj should maintain strong, cooperative relationships with its suppliers, especially for perishable items. Dual-sourcing strategies

should continue to be employed, as they allow SarTaj to manage supplier risks, ensuring both quality and cost efficiency.

Engaging suppliers in a *more collaborative partnership*, including integrating their expertise into menu development and allowing for joint planning of inventory, will strengthen supply chain resilience and add value to the hotel's offerings.

Increasing Efficiency with Outsourced or Hybrid Models

SarTaj could consider adopting a hybrid approach by combining *in-house production for signature items with outsourced options for more standardized offerings*. This model will allow for efficiency in operations while maintaining the brand's focus on delivering unique customer experiences.

Outsourcing routine tasks, such as bulk food preparation for events and conferences, can free up resources and staff time, allowing hotels to *focus on delivering exceptional service in high-impact areas*.

Conclusion

The SarTaj Hotels' supply chain has significant potential for improvement, especially in leveraging data for demand forecasting, increasing the use of technology, and optimizing labor costs through outsourcing. By addressing these weaknesses, SarTaj can enhance its supply chain efficiency, reduce operational costs, and continue to deliver high-quality service, further strengthening its position as a leader in the hospitality industry.

CASE STUDY 7

As a sunrise sector, India's skill-based online gaming industry could play a crucial role in making India a US$5 trillion economy by 2025. Online games may be categorized into two broad categories basis the involvement of element of skill and chance – skill-based games (i.e. where the outcome is mostly dependent upon player's skills, knowledge, training, etc. with less/minimal dependence on chance factor) and chance-based games (i.e. games where the outcome is primarily dependent upon chance and wherein player's skills, knowledge, etc. have limited influence over the same). The online skill-based gaming industry in India may be categorised into real money games (RMG) (a game where a user makes a deposit in cash or kind

with the aim of earning winnings on the deposit) and non-real money games (non-RMG). Skill based games are played in one of the following formats, namely – casual games, card games, fantasy sports, etc.

The online game industry has undergone a significant evolution from its humble beginnings of pixelated arcade games in the 1970s to ~US$ 200 billion industry with cutting-edge graphics, immersive gameplay, and an ever-expanding audience. With an estimated 3 billion active players worldwide, the gaming industry has a massive and growing audience. In fact, approximately 50% of these active players are also active buyers of in-game assets, such as virtual goods. This highlights the significant economic potential of the gaming industry and its ability to generate substantial revenue through in-game purchases and other related transactions. Gaming is rapidly emerging as the future of entertainment, with its market size already surpassing that of the global music and movie industries. In fact, the gaming industry is currently 7 times larger than the global music industry and 5 times larger than the global movie industry, making it a major player in the entertainment landscape.

India's online gaming segment is experiencing remarkable growth, indicating substantial economic potential. With a robust gaming community consisting of approximately 42.5 crore gamers—second globally after China − the sector has potential to accelerate Foreign Direct Investment inflows, job creation, and investments across various sectors. For the segment to truly thrive, a stable regulatory and legal framework is imperative. Uncertainties can impede the realization of its full potential and hinder rapid scalability. Over the past three years, the online gaming industry has grown at a CAGR of 28%, reaching ₹ 16,000 crore in F.Y.2023-24 and is likely to reach ₹ 32,000 crore by F.Y.2027-28. This boost is largely attributed to factors like widespread smartphone penetration, improved internet connectivity, a growing youth population, and the development of local gaming content. Over the course of time as younger generations become the key customers, the spending patterns and the market is expected to shift to become a core gaming market. Additionally, the pandemic played a significant role in driving up mobile game downloads as people sought digital entertainment. India continues to be a 'mobile first' market, with 94% of

its gamer base engaging in mobile gaming. Despite the rapid increase in game consumption, India's online gaming revenue is still merely 1.1% of global online gaming revenue.

As online gaming continues to catalyse ancillary sectors like fintech, cloud services, data analytics, and cybersecurity, India takes a significant leap in its digital economy landscape. The growth of this segment poses an enabling environment for future investments and potential economic development. Guidelines by the Ministry of Electronics and Information Technology have been instrumental in removing ambiguity, bolstering investor sentiment, attracting funding, and encouraging innovations in India's digital economy, while prioritising user safety. India is witnessing increasing financial and digital inclusion boosting the growth of the gaming industry. The growth mainly is driven by the following factors:

- India, with the highest population in the world at 1.4 billion also boasts of one of the largest markets for smartphones. This increased digital penetration catalysed by the affordability of mobile data and accessibility of smartphones is further supporting the expansion of the skill-based online gaming industry in India. Another pertinent development is the burgeoning production of smartphones in India that has led to the availability of advanced specifications of smartphones at an affordable rate.
- As 5G services are rolled out throughout the country, it may unlock a new era of cloud gaming, super-fast downloads, high-quality live streams, and seamless multiplayer online gaming. 5G may also enable more realistic Extended Reality (XR) and empower large-scale, platform-agnostic events and social experiences with seamless interactions between users.
- In absolute numbers, India may have a working-age population of more than a billion by 2030. With the largest youth population in the world, the median age in the country is just 28 years. A young demographic means an increasing inclination towards various types of gaming products and services available in the market.

Fastest Finger Limited (FFL) founded by Mr. Viper Armstrong has embarked on the mission to enhance India’s footing in the global landscape. With innovation and adaptability at core, FFL is positioned

to not only match the pace of change in the gaming world but to take the lead as it undergoes a massive transformation. FFL is a diversified gaming and sports media platform headquartered in Bangalore, with a presence in both developing and developed global markets such as Africa and North America. FFL is confident in shaping the future and expanding its leadership, both in India and globally, with operational efficiencies and industry-leading mindset. Refer annexure for details on FFL's popular games.

F.Y. 2023-24 has proven to be another year of progress for the company, FFL continue to rank among the popular companies worldwide. While FFL faced certain challenges that tested its resilience, FFL emerged triumphant but delivered muted results.

FFL's existing business strategy comprise the following:

Segment	Organic growth	Inorganic growth
Gaming 	Focus on driving organic growth through strategic investments in user acquisition with a strong emphasis on sustainable unit economics. Consistently update product features and content to improve user retention, engagement, and satisfaction, fostering long-term customer loyalty.	Expand the gaming vertical by acquiring games with valuable intellectual properties (IPs) that demonstrate high growth potential and the ability to deliver a 20% EBITDA margin. Leverage existing expertise in user acquisition and analytics to maximize the post-acquisition performance and accelerate market presence.
eSport 	Fuel non-linear EBITDA growth by enhancing internal capabilities, expanding the local ecosystem, and consolidating leadership in the Indian market. Strengthen	Develop a comprehensive 360-degree eSports ecosystem by exploring acquisitions of specialized brands or capabilities, particularly in the US sports sector. These strategic acquisitions will

	brand positioning through internal innovation, community engagement, and organic market penetration.	help diversify FFL's portfolio and expand its market reach globally.

Mr. Viper Armstrong, the CEO, is concerned about FFL's prospects for the future. FFL is suffering from strategic drift and has no clear vision about its purpose or direction. It is active in the domestic and international markets but is consistently losing its dominant presence. There are no plans to put more investment into promoting foreign revenue.

A particular concern is a long-term contract to provide Teen Patti (i.e., premium online new games) facilities to a major theme park in India. This five-year contract is due to end next year, and although it may be renewed, the CEO suspects that the customer may switch its business to a larger competitor. Loss of this contract would have a serious impact on FFL's business, reducing annual profit by as much as 10% and almost certainly leading to some redundancies among the work force.

The CEO is aware from lengthy discussions with the product development team that FFL could invest in developing a more engaging and revamped type of premium online gaming experience for the domestic market. Developing this new gaming experience would, however, require a substantial capital investment. It would also mean having to resort to from external designers/ resources. It would also mean having to appoint some experienced personnel to research and development unit, because FFL does not currently have resources with sufficient knowledge of the new technology.

The product development team are all in favour of the new investment, and the CEO believes that such investing will give FFL a much clearer strategic vision of what it should be trying to achieve. Some colleagues disagree strongly. The Operations Director sees no need to change the offering that FFL has been making successfully and the Sales and Marketing Director believes that the contract with the major customer will be renewed next year. Human Resources relations are also not good in FFL, following strike action last year in support of a claim for a pay rise and against planned redundancies amongst the staff. No one

seems to understand the need for a new product, or the reason for change.

The achievement of the above objectives would entail significant funding. Considering the quantum of investment required FFL decided to list its shares on the recognised Indian stock exchanges. The Initial Public Offer would comprise of fresh issue of equity shares, aggregating up to ₹ 500 crores. FFL would utilize the Net Proceeds towards funding the following objects:

- The business is working capital-intensive, and FFL funds its working capital requirements in the ordinary course of business from internal accruals and financing from various banks and financial institutions. As of 31 December 2023, FFL had a total sanctioned limit of working capital facilities of ₹ 350 crores on a consolidated basis, including fund based and non-fund based sub-limits, and had an aggregated outstanding borrowing of ₹ 215 crores on a consolidated basis. FFL proposes to utilize an amount of up to ₹ 100 crores of Net Proceeds, towards working capital requirements of FFL in F.Y.2024-25 and F.Y. 2025-26.
- FFL seeks to continue expanding its offerings to include emerging areas such as Metaverse leveraging artificial intelligence, and ancillary services. FFL intends to expand into these new verticals through strategic partnerships and acquisitions. By diversifying into new related verticals, FFL seeks to be able to attract more users to its platforms, increase user engagement and serve as a comprehensive 'one-stop' solution. In addition to growing business organically, FFL have in the past and may continue to pursue targeted acquisitions or investments that complement its service offerings, strengthen or establish presence in target market or help in gaining access to new markets, technology and teams. FFL expects to utilize the remaining of the Net Proceeds towards funding inorganic growth segment through unidentified acquisitions and other strategic initiatives and general corporate purposes.

Since FFL is in the process of being listed, Companies Act, 2013 would require it to prepare its financial statements under Ind AS. The first set of financial statements under Ind AS which comprise the balance sheet as at the end of the financial year, statement of profit and loss, statement of cash flow for the financial year; statement of changes in equity; and any explanatory note annexed to. The first set of Ind AS financial statements would also include three balance sheets i.e.,

balance sheets as at 31stMarch 2024, 31stMarch 2023 and 1stApril 2022.

First time implementation of Ind AS posed many challenges including determination of comparative information including opening balance sheet and reconciliations as at the transition date. Accordingly, CFO was given the responsibilities to identify the GAAP differences and suggest the transition options. The CFO suggested as follows:

- Elected the deemed cost exemption in accordance with the relevant Ind AS which permits to continue with the carrying value for all of its property, plant and equipment as per the previous GAAP and use that as deemed cost for the purposes of first-time adoption of Ind AS.
- Entity, being the first-time adopter may elect not to apply Ind AS 103 retrospectively to past business combinations (business combinations that occurred before the date of transition to Ind ASs).

The CFO also mentioned that FFL had made certain investments in Dream Play Limited's convertible debt instruments. The conversion rights are substantive rights and would provide FFL with a controlling stake over Dream Play. FFL has evaluated that Dream Play Limited would be treated as its subsidiary under Ind AS and, hence, would require consolidation in its Ind AS based consolidated financial statements. Dream Play Limited was not considered as a subsidiary, associate or a joint venture under previous GAAP.

Under the latest GST norms, the CFO's snapshot of amount received towards online money is as follows:

- The total amount received from online bets is ₹ 35 crores after 1st October, 2023. After accounting for refunds amounting to ₹ 1 crore and unused or returned amounts totaling ₹ 4 crores, the amount utilized for the purpose of placing online bets is ₹ 30 crores.
- FFL also received a demand cum show cause notice from the GST department alleging that non-payment of GST of ₹ 50 crores in the previous years. FFL filed an appeal by 31st March 2024 against the demand notice.

On 15th April,2024, a Board Meeting was called to discuss the matters on hand. This included matter related to FFL's listing on 28th March,2024 and approval of financial statements for the F.Y.2023–24. Mr. Viper Armstrong, the CEO of FFL attended the Board Meeting

through video conference. Other directors attended the Board Meeting physically.

ANNEXURE

Extract of Statement on Matters Specified in paragraphs 3 and 4 of the Companies (Auditors Report) Order, 2020 from the Independent Auditor's Report

vii) (a) According to the information and explanations given to us, and based on the audit procedures performed by us, in our opinion, amounts deducted/ accrued in the books of account in respect of undisputed statutory dues including Goods and Services Tax ('GST'), Provident fund, Employees' State Insurance, Income-Tax, Duty of Customs, Profession Tax, Cess and other statutory dues have been regularly deposited by the Company with the appropriate authorities wherever applicable, and there are no such outstanding dues as at March 31, 2024, for a period of more than six months from the date they became payable.

(b) According to the information and explanations given to us and on the basis of our examination of the records of the Company, statutory dues relating to Goods and Services Tax ('GST') which have not been deposited on account of any dispute are as follow:

Name of Statute	Nature of dues	Amount not deposited on account of demand (In crore)
Goods and Service Tax, 2017	GST	50.00

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FFL's Popular Games

Chakde India	Teen Patti	Z Sports	NOX-A
▪ World's largest cricket simulation game with 1.5 million daily active users and 9 million monthly active users ▪ Revenue grew by 7% (last year: 10%) ▪ Shows reduced retention	▪ Classic card games. A Premium offering by FFL ▪ Revenue grew by 8% (last year: 12.5%) ▪ FFL is further strengthening its position in this sector	▪ Multi-sports destination. Dominant position in key markets ▪ Revenue grew by 14% (last year: 25%) ▪ Strong customer loyalty followed with high unique customer additions	▪ This innovative game is having a life cycle of less than one year ▪ Currently, it is in the introduction stage of its life cycle and is generating significant unit profits ▪ FFL adopted a market skimming pricing policy

metrics with Day 1 retention of 46%, Day 7 retention of 18% and Day 30 retention of 7% in F.Y. 2023-24			▪ FFL expects that other companies will try to join the market very soon

I. Multiple Choice Questions

7.1 Which of the following statements is correct with respect to the Ind AS transition option chosen by Fastest Finger Limited for the property, plant and equipment?

(a) Not a carve out – Like IFRS 1, Ind AS 101 also does not provide an additional option to continue with the carrying value for property, plant and equipment as per previous GAAP and use that as deemed cost for the purposes of first-time adoption of Ind AS.

(b) Carve out – Unlike IFRS 1, Ind AS 101 provide an additional option to continue with the carrying value for property, plant and equipment as per previous GAAP and use that as deemed cost for the purposes of first-time adoption of Ind AS.

(c) Carve out – Unlike IFRS 1, Ind AS 1 provide an additional option to continue with the carrying value for property, plant and equipment as per previous GAAP and use that as deemed cost for the purposes of first-time adoption of Ind AS.

(d) Not a carve out – IFRS 1 and Ind AS 101 are identical with no changes in any of the paragraphs and provisions.

7.2 Date of transition to Ind AS for Fastest Finger Limited is_____?

(a) 31st March, 2024

(b) 1st April, 2023

(c) 31st March, 2023

(d) 1st April, 2022

7.3 In the Board Meeting, Mr. Viper Armstrong expressed his concern that approval of financial statements for the year ended 31stMarch,2024 cannot be approved through video conferencing. Do you agree?

(a) Disagree. Since there is quorum in a meeting through physical presence of directors, Mr. Viper Armstrong can participate through video conferencing on the matters relating to approval for annual financial statements as permitted under section 173 to the Companies Act, 2013.

(b) Partially Agree. Since there is quorum in a meeting through physical presence of directors, Mr. Viper Armstrong can participate in discussion through video conferencing but cannot approve the annual financial statements as it is not permitted under section 173 to the Companies Act, 2013.

(c) Agree. Rule 4 of the Companies (Meetings of Board and its Powers) Rules,2014 prohibits approval of annual financial statements in a Board Meeting conducted through video conferencing.

(d) Disagree. Section 173 to the Companies Act, 2013 do not prohibit approval of annual financial statements in a Board Meeting conducted through video conferencing. Meeting quorum through physical presence of directors is not necessary.

7.4 The amount of GST liability in respect of the amount received from online bets is_____.

(a) ₹ 5.81 crores

(b) ₹ 11.30 crore

(c) ₹ 9.80 crores

(d) ₹ 30.11 crores

7.5 With reference to Paragraph 3(vii)(b) of CARO 2020, Whether reporting under CARO is appropriate (refer Annexure):

(a) Reporting is appropriate. The extract includes all the information prescribed under CARO, 2020.

(b) Reporting is appropriate. The extract includes all the information prescribed under CARO, 2020, to the extent considered material by the auditor.

(c) Reporting is inappropriate. CARO, 2020, requires the auditor to also report the period to which the amount relate and the forum where the dispute is pending.

(d) Reporting is inappropriate. CARO, 2020, requires the auditor to also report the forum where the dispute is pending.

II. Descriptive Questions

7.6 How should Dream Play Limited be consolidated on transition to Ind AS considering that Fastest Finger Limited has opted to avail the exemption from retrospective restatement of past business combinations as permitted under the relevant Ind AS?

7.7 How can Fastest Finger Limited (FFL) realign its strategic direction and address internal conflicts APPLYING McKinsey's 7S Framework to drive innovation, enhance compliance, and secure its competitive position in the gaming industry?

7.8 Briefly describe the relevant provisions that would have been considered for the conduct of Board meeting through video conference on 15th April, 2024 as Mr. Viper Armstrong attending it through such mode?

7.9 ANALYSE, with reasons, the changes, if any, to the unit selling price and the unit production (development) cost that could occur when NOX-A moves from the previous stage into each of the following stages of its life cycle in the context of the online gaming industry:

(i) Growth

(ii) Maturity

ANSWERS TO THE CASE STUDY 7

I. Answers to the Multiple Choice Questions

7.1 (b) Carve out – Unlike IFRS 1, Ind AS 101 provide an additional option to continue with the carrying value for property, plant and equipment as per previous GAAP and use that as deemed cost for the purposes of first-time adoption of Ind AS.

Reason: Paragraph D7AA of Ind AS 101 has been added to provide for transitional relief from the retrospective application of Ind AS 16: Property, Plant and Equipment. Paragraph D7AA, provides an entity option to use carrying values of all such assets as on the date of transition to Ind ASs, in accordance with previous GAAP as an acceptable starting point under Ind AS.

7.2 (d) 1stApril,2022

Reason: The date of transition will be 1st April, 2022 being the beginning of the earliest comparative period presented. To explain it further, Fastest Finger Limited is required to adopt Ind AS for F.Y.2023-24, and it will provide comparatives for F.Y.2022-23. Accordingly, the beginning of the comparative period i.e. 1stApril,2022 will be considered as date of transition.

7.3 (a) Disagree. Since there is quorum in a meeting through physical presence of directors, Mr. Viper Armstrong can participate through video conferencing on the matters relating to approval for annual financial statements as permitted under section 173 to the Companies Act, 2013.

Reason: The participation of Directors in a meeting of the Board may be either in person or through video conferencing or other audio visual means, as may be prescribed, which are capable of recording and recognising the participation of the Directors and of recording and storing the proceedings of such meetings along with date and time.

7.4 (c) ₹ 9.80 crores

Reason: Under Rule 31B of the CGST Rules, 2017 any amount returned or refunded by the supplier to the player for any reasons whatsoever, including player not using the amount paid or deposited with the supplier for participating in any event, should not be deductible from the value of supply of online money gaming. Accordingly, GST @28% is payable on the entire amount of ₹ 35 crores.

7.5 (c) Reporting is inappropriate. CARO, 2020, requires the auditor to also report the period to which the amount relate and the forum where the dispute is pending.

Reason: Where statutory dues have not been deposited on account of any dispute, then the name of statute, nature of dues, amount not deposited, period and the forum where dispute is pending should be mentioned in auditor's report under CARO. [Paragraph 3(vii)(b) of CARO 2020]. The auditor has not disclosed the period and forum where the dispute is pending.

II. Answers to the Descriptive Questions

7.6 Appendix C to Ind AS 101 prescribes an optional exemption from retrospective restatement in relation to past business combinations. Paragraph C(4)(j) of Appendix C to Ind AS 101 prescribes that when the past business combinations are not restated and a parent entity had not consolidated an entity as a subsidiary in accordance with its previous GAAP (either because it was not regarded as a subsidiary or no consolidated financial statements were required under previous GAAP), then the subsidiary's assets and liabilities would be included in the parent's opening consolidated financial statements at such values as would appear in the subsidiary's separate financial statements if the subsidiary were to adopt the Ind AS as at the parent's date of transition.

It may be noted here that the above exemption is available only under those circumstances where the parent, in accordance with the previous GAAP, has not presented consolidated financial statements for the previous year; or where the consolidated financial statements were prepared in accordance with the previous GAAP, but the entity was not treated as a subsidiary, associate or joint venture under the previous GAAP. As such, if the consolidated financial statements were required to be prepared and there is a change in classification of the entity from subsidiary to associate or vice versa in accordance with Ind AS, then the above exemption does not apply.

In the present case, the subsidiary's separate financial statements would be prepared as if it was a first-time adopter of Ind AS i.e. after availing relevant first-time adoption mandatory exceptions and voluntary exemptions. The parent will adjust the carrying amount of the subsidiary's assets and liabilities to the amounts that Ind ASs would require in the subsidiary's balance sheet.

The deemed cost of goodwill equals the difference at the date of transition between:

(a) the parent's interest in those adjusted carrying amounts; and

(b) the cost in the parent's separate financial statements of its investment in the subsidiary.

The measurement of non-controlling interest and deferred tax follows from the measurement of other assets and liabilities.

7.7 Applying McKinsey's 7S Framework to **Fastest Finger Limited (FFL)** highlights several areas where improvement is necessary for achieving strategic success.

Strategy: FFL is experiencing strategic drift, with unclear direction and resistance to new initiatives. To address this, the strategy must be communicated effectively to all managers and employees involved. The current approach, combining organic and inorganic growth, needs refinement, particularly in innovation and managing risks associated with the **Teen Patti** contract. A clearer focus on product development and enhancing the premium online gaming experience will help restore FFL's competitive edge.

Structure: FFL operates in domestic and international markets with a structure that supports diverse gaming and e-Sports segments. However, misalignment across functional units threatens the success of the change program. To support its growth and innovation objectives, FFL must streamline its structure to promote cross-functional collaboration and align with its strategic goals.

Systems: The company is transitioning to **Ind AS** and dealing with **GST compliance** issues, both of which are critical for managing growth and regulatory requirements. FFL needs robust financial systems to handle these complexities, and addressing compliance issues will be essential for maintaining investor confidence.

Shared Values: There is a lack of consensus on the need for new product development and strategic direction. This disconnects between leadership and staff underscores the importance of shared values. The CEO’s concerns about the company's future have not been communicated clearly, leaving employees uncertain. Fostering a culture of innovation and ensuring alignment on strategic goals across the organization will help overcome resistance to change and drive growth.

Skills: FFL lacks expertise in new gaming technologies, which is critical for developing new products and maintaining competitiveness. The company must invest in hiring senior resources for research and development and possibly engage external designers. Strengthening its technical capabilities will be essential for supporting innovation and future product development.

Style: Internal disagreements over FFL's direction and investment strategies are causing friction. The CEO has not secured commitment

from key managers, such as the operations and sales directors, who are skeptical about the need for technological advancements. To move forward, leadership must resolve these conflicts and create a collaborative environment that encourages innovation and adaptability.

Staff: FFL faces human resource issues, including potential redundancies and dissatisfaction among operations staff. The reliance on external resources and technical experts may be seen as a threat to existing employees. Additionally, the failure to coordinate the new program with the sales team could undermine its success. Effective HR management, clear communication about strategic changes, and investment in talent acquisition and development are crucial to maintaining morale and productivity.

Conclusion

Fastest Finger Limited needs to realign its strategic direction by refining its growth strategy, revising its organizational structure, and investing in key skills and technologies. Clear communication and fostering a shared vision are essential to overcoming resistance to change. By resolving internal conflicts and creating a collaborative environment, FFL can drive innovation, ensure compliance, and secure its competitive position in the gaming industry.

7.8 Section 173(2) of Companies Act, 2013 read with Rule 3 of the Companies (Meetings of Board and its Powers) Rules, 2014, provide that participation of directors in a meeting of the Board may be either in person or through video conferencing or other audio-visual means as may be prescribed, which are capable of recording and recognizing the participation of the directors and of recording and storing the proceedings of such meetings along with date and time. Chairman of the Meeting and Company Secretary should safeguard the integrity of the meeting by ensuring sufficient security and identification procedures, ensure availability of proper video conferencing or other audio visual equipment or facilities for providing transmission of the communications for effective participation of the directors and other authorised participants at the Board meeting and other matters as prescribed in the above Rule.

The **notice of the meeting** shall be sent to all the directors 7 days in advance as per section 173 (3) of the Act and the notice shall inform the directors regarding the option available to them to participate through video conferencing mode or other audio-visual means and

shall provide all the necessary information to enable the directors to participate through video conferencing mode or other audio-visual means.

Key points to be observed before/ during the meeting are as follows:

STEP 1: Roll Call

At the commencement of the meeting, a Roll Call should be taken by the Chairperson when every director participating through video conferencing or other audio-visual means shall state, for the record, the prescribe matters including name; location from where participating and that he has received the agenda and all the relevant material for the meeting

STEP 2: Considerations for the Chairman or Company Secretary

The Chairperson / Company Secretary would then read out the names of persons (other than the Directors who are present at the meeting) to assist/guide/witness the proceedings of the Meeting the Board. The **attendance register shall be deemed to have been signed by the directors** participating through electronic mode, if their attendance is recorded by the Chairman or FFL Secretary in the attendance register and the minutes of the meeting.

STEP 3: Requirement of Quorum

The Chairperson / Company Secretary should confirm that the **required quorum** is present throughout the meeting.

The statutory registers which are required to be placed in the Board meeting should be placed at the scheduled venue of the meeting.

STEP 4: Transaction during Meeting

Each item of business should be taken up one by one as per the agenda specified in the notice. If a motion is objected to and there is a need to put it to vote, the Chairperson shall call the roll that is to say that he shall first announce that he shall be doing the roll call and call out the name of each director who shall identify himself while casting his vote and the Chairperson shall then note the vote of each director. The Chairperson shall then **announce the summary of the decision** taken on such item along with names of the directors, if any, who dissented from the decision taken by majority.

7.9 (i) Growth

(ii) Maturity

Growth Stage

Compared to the introduction stage, the likely changes for NOX-A in the online gaming industry are as follows:

Unit Selling Prices (In-game purchases or subscriptions): The prices for in-game purchases or subscription fees *may reduce* for several reasons:

- *Competitors are likely to enter the market* with similar games, pushing NOX-A to reduce prices to stay competitive.
- To increase its user base and discourage new entrants, NOX-A might adopt *aggressive pricing strategies, offering discounts or promotions*.
- As the player base expands, lowering prices might make the game accessible to a wider audience, driving growth in terms of both revenue and user engagement.

Unit Production (Development) Costs: Development and operational costs are *likely to decrease* due to:

- Economies of scale: Larger player volumes lead to more efficient server utilization and *reduced per-user maintenance costs*.
- Improved efficiency in game updates: As the development team becomes more familiar with the game mechanics and platform, the *learning curve effect helps in streamlining production processes*.
- Bulk purchasing of cloud and IT services: With increased demand, NOX-A can negotiate better deals for cloud hosting, IT infrastructure, and other development resources, *reducing overhead costs*.

Maturity Stage

Compared to the growth stage, the changes in the maturity stage for NOX-A are as follows:

Unit Selling Prices (In-game purchases or subscriptions): At this stage, the game has likely captured a significant share of the market. Hence:

- *Prices are likely to stabilize* as NOX-A has now established itself in the online gaming community. There may be

occasional promotions or limited-time offers, but overall pricing remains consistent.

- There might be less pressure to lower prices further as the *focus shifts to customer retention* rather than rapid expansion.

Unit Production (Development) Costs: Costs are likely to *Stable or Slightly Increasing Costs due to:*

- The efficiency gains from the learning curve and scale have plateaued, leading to more stable development costs.
- Direct development costs may remain constant but could also rise due to ongoing investment in keeping the game relevant with new features, content, and user experience improvements.
- As the game reaches a stable player base, additional resources might be needed for customer service, moderation, and security, particularly as user expectations evolve.

Conclusion

In conclusion, during the **growth stage**, the key trend for NOX-A is *likely a reduction in both unit selling prices and production costs* as it seeks to expand its user base and benefit from economies of scale. However, in the **maturity stage**, *prices tend to stabilize* while *production costs could slightly increase or remain constant* as the focus shifts to retaining players and maintaining the game's relevance through continuous development.

CASE STUDY 8

From humble beginnings as a small trading business in 1970s Mumbai, Aadhya Ltd. has emerged as one of India's most prominent and diversified conglomerates. What started as a family-run operation is today a professionally managed group with a multinational presence and over 5,000 employees. Headquartered in a towering glass edifice in Mumbai's business district, Aadhya Ltd.'s operations span multiple verticals – infrastructure, power, telecom, retail and financial services. The company takes immense pride in its stellar senior leadership drawn from India's premier institutes.

At the helm is Rajesh Sharma, who rose through the ranks to become the Chairman and Managing Director in 2016. Assisting him is a dynamic top management team that includes Chief Financial Officer Nisha Patel and Chief Operating Officer Rakesh Raghavan. ***"Our vision is to build a globally respected Indian conglomerate that creates sustainable value through ethical business practices, innovation and operational excellence,"*** Rajesh articulates the group's driving philosophy. This vision extends beyond just financial growth to include environmental sustainability and holistic societal impact.

The group's entrepreneurial culture and diversity & inclusion policies have made it a dream employer, consistently ranked among India's best companies to work for. At the heart of Aadhya Ltd.'s operations is its state-of-the-art digital transformation journey cutting across business verticals. From smart factories and intelligent supply chains to mobile-first retail offerings, the conglomerate has thoroughly embraced emerging technologies. Its in-house R&D and innovation labs are at the cutting edge of fields like AI, IoT, Blockchain and more. However, Aadhya Ltd.'s impact transcends just business. The Aadhya Foundation runs skills training programs, schools, hospitals and disaster relief efforts that have uplifted lakhs of underprivileged lives across India. The group is a pioneer in corporate social responsibility, deploying both human and financial capital to drive sustainable development initiatives.

Aadhya Ltd. is gearing up for its next phase of global growth, led by forward-thinking leadership and a motivated workforce. As a homegrown giant, it’s set to create a lasting legacy as a leading Indian multinational. Its remarkable success stands as a testament to the entrepreneurial spirit and ambition of India.

It was a crisp autumn morning in October 2020 when Rajesh Sharma, the MD of Aadhya Ltd., stepped into the boardroom to meet his leadership team including Nisha Patel, the CFO. *“We’ve identified an opportunity with Suraksha Constructions,”* Rajesh began. Nisha explained that *Suraksha was a stagnant mid-sized construction firm but integrating it could unlock potential synergies*. After extensive negotiations and due diligence, Aadhya Ltd. announced the acquisition in December. The fair value of Suraksha’s total assets excluding liabilities was ₹ 3,060 crore on acquisition, with ₹ 48 crore estimated as costs to sell. The fair value of liabilities stood at ₹ 510 crore. The integration was challenging, but eventually, cost savings and efficiencies materialized. However, Rajesh and Nisha intended to turn

around Suraksha and spin it off. By the time, as Aadhya Ltd. explored selling the former Suraksha unit, the fair value of its total assets excluding liabilities had changed to ₹ 3,000 crore, while costs to sell remained ₹ 48 crore and liabilities were valued at ₹ 528 crores. After weighing various offers, they struck a deal with a global private equity firm specialized in construction. While inking the final documents, Rajesh had a pleased expression. The divestment would unlock capital to focus on Aadhya Ltd.'s core competencies. More importantly, it was a learning experience that would shape their approach to future growth opportunities. Nisha too was satisfied with the outcome and looked forward to redeploying resources optimally to create long-term shareholder value.

The month of July 2021 marked a transition of leadership at Aadhya Ltd., one of India's leading conglomerates. Vihaan Mehta, a rising star within the company, was appointed as the new Managing Director, succeeding the long-serving Rajesh Sharma. The boardroom buzzed with excitement as Vihaan took charge, outlining his vision to propel Aadhya Ltd. to new heights through strategic initiatives and operational excellence. However, his remuneration package soon became a subject of debate among certain shareholders. The company had decided to pay Vihaan a competitive compensation suitable to his new role and responsibilities. Rajveer Bhatia, a minority shareholder actively tracking company, sought to inspect the contract detailing Vihaan's remuneration terms. But he was denied access by the company on the grounds that no written contract existed with the new Managing Director.

It was early 2023 when Aadhya Ltd., the prominent Indian conglomerate, found itself under the scanner from some minority shareholders. The company had expanded rapidly into new verticals under the leadership of its newly appointed Managing Director Vihaan Mehta. However, these shareholders raised concerns over certain transactions entered into by Aadhya Ltd. They alleged that these transactions were not fully compliant with the provisions of the Companies Act, 2013 and were potentially prejudicial to the company's interests. Worried by these developments, the shareholders decided to invoke their statutory rights. They moved to make an application to the Central Government in late 2023, seeking appointment of an Inspector to investigate the affairs of Aadhya Ltd. The shareholders were determined to ensure that Aadhya Ltd.'s growth plans didn't come at the cost of governance lapses or violating the legal framework governing the company's operations. Furthermore, a group of members of Aadhya

Ltd., holding 12% of the company's issued share capital, has filed a petition before the Tribunal alleging acts of oppression and mismanagement by the majority shareholders. During the petition's pendency, some members holding 5% of the share capital wish to withdraw. The majority shareholders, along with these withdrawing members, argue that the petition should be dismissed as non-maintainable.

During the last quarter of the financial year 2023-24, the Aadhya Group navigated several complex transactions, focusing on meticulous financial practices and strategic decisions. One notable deal involved Aadhya Ltd. supplying specialized machinery to XYZ Traders for ₹ 2,95,000, inclusive of GST at 18%. In conjunction, XYZ Traders provided materials valued at ₹ 10,000, exclusive of GST, as part of the consideration. Vihaan Mehta, the new MD, keenly monitored this transaction. He convened a meeting with CFO Nisha Patel and COO Rakesh Raghavan to review the details. "*We need to ensure every aspect of this deal is handled meticulously*," Vihaan emphasized. Around the same time, Aadhya Enterprises Ltd., a subsidiary of Aadhya Ltd., supplied the same machinery to another unrelated party for ₹ 2,97,360, inclusive of GST at 18%. This prompted the finance team to discuss the valuation and pricing strategies. Nisha explained, *"For the machinery supplied to XYZ Traders, we must calculate the value before GST and add the value of the additional materials provided."* Rakesh noted, *"Comparing this to the transaction made by Aadhya Enterprises Ltd. will help ensure our pricing strategy is consistent and competitive."* After careful calculation, they concluded that the value of the goods supplied to XYZ Traders needed thorough documentation for accurate financial reporting. This exercise not only clarified the value but also reinforced Aadhya Ltd.'s commitment to meticulous financial practices. Vihaan, satisfied with the outcome, reflected on the importance of detailed evaluations in maintaining the company's reputation for excellence and integrity.

Simultaneously, Aadhya Enterprises Ltd. was also deliberating over two significant loan proposals as part of its strategic focus on employee retention and welfare. The first proposal concerned a substantial personal loan requested by K. Ahuja, one of the company's directors, aimed at financing the construction of his residential property. This loan was being considered in light of Ahuja's long-standing contributions to the company and the potential role such financial assistance could play in ensuring his continued engagement with Aadhya Enterprises Ltd. The second proposal

pertained to a loan sought by Bharat Mehta, the company's Whole-Time Director, though the specific purpose for this loan has not been explicitly stated. Despite the lack of clarity on the loan's objective, the Board was weighing carefully the request, considering the importance of supporting Key Managerial Personnel within the organization.

In parallel, Aadhya Ltd. prepared for an important international trade operation, set to import goods worth USD 2 million from an overseas supplier. Typically, the company required 90 days to make the payment. The supplier offered a 60-day interest-free credit period, along with an additional 30-day credit extension at an 8% per annum interest charge. Meanwhile, Aadhya Ltd.'s bankers presented a 30-day loan facility at a 10% per annum interest rate. The finance team, led by CFO Nisha Patel, evaluated these options against current foreign exchange rates: a spot rate of 1 USD = ₹ 83.50, a 60-day forward rate of ₹ 84.10, and a 90-day forward rate of ₹ 84.50, recognizing the potential impact on the company's financial position.

While addressing these corporate developments, Vihaan also led discussions about the Aadhya Foundation, emphasizing the importance of aligning social responsibility programs with core values and actively engaging with local communities. *"We must adapt our strategies based on their feedback to ensure that our foundation uplifts communities and fosters a lasting legacy,"* he stated.

As the financial year 2023-24 near to close, Aadhya Ltd. was gearing up for its annual audit process. Nisha Patel, the Chief Financial Officer, had the accounts payable break-up ready for scrutiny. DRT & Co. were appointed to conduct Aadhya Ltd.'s audit for the year. As they reviewed the accounts payable, one particular vendor – M/s Builders Corp. with a sizable ₹ 14.56 Lakhs payable – caught their attention.

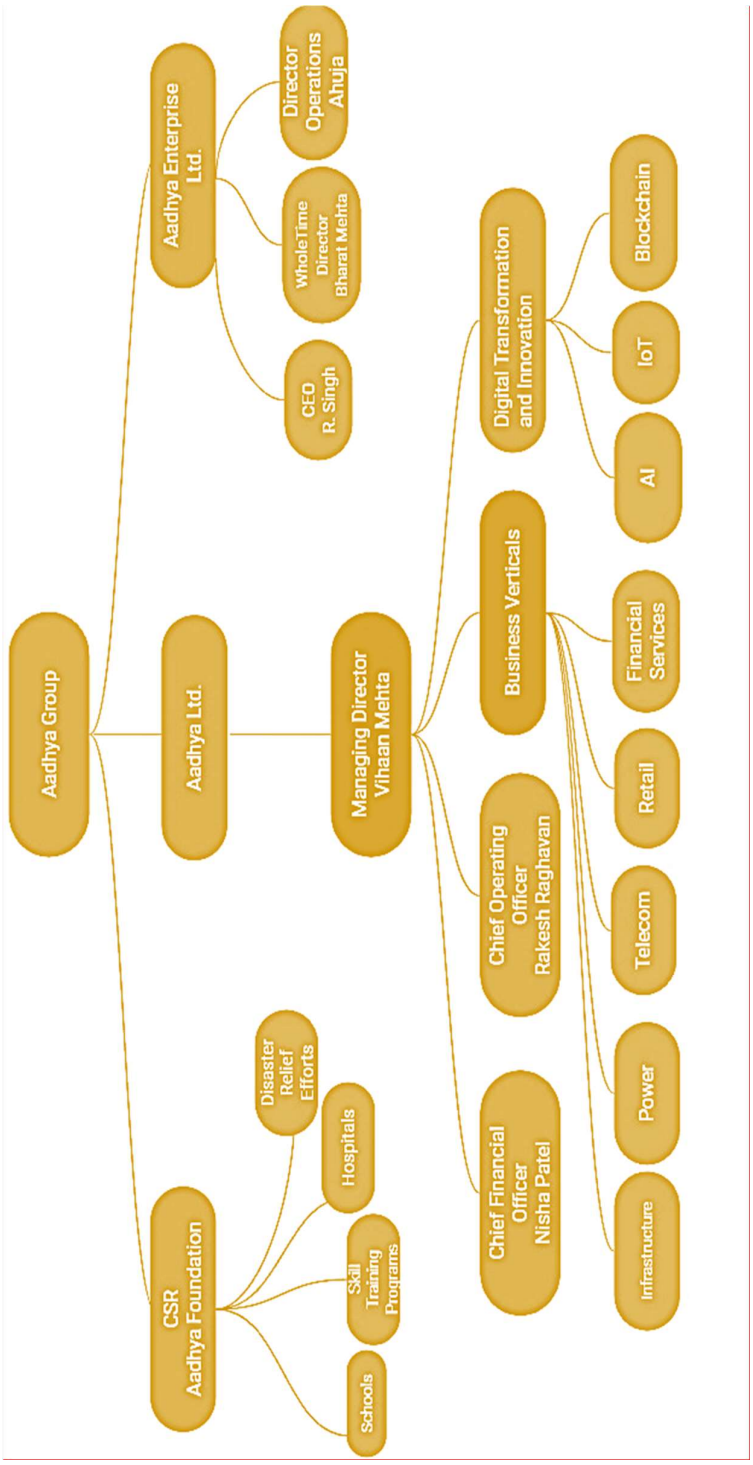
In May 2024, an important financial issue arose that required immediate attention. DRT & Co., the auditors of Aadhya Ltd. for the year ended on 31/03/2024, had signed the audit report on 04/05/2024. The Annual General Meeting was scheduled for August 2024. On 06/05/2024, the company received a communication from the Central Government that an amount of ₹ 20 crore, kept pending on account of incentives pertaining to the financial

year 2023-24, had been approved and would be paid before the end of May 2024. When asked about this by the management, Chief Financial Officer Nisha Patel informed them that this amount had not been recognized in the audited financial statements due to uncertainty of receipt before the financial year end. Now, having received confirmation of the amount, the management wished to include it in the financial statements for the year ended 31/03/2024. On 08/05/2024, the management amended the accounts and approved the same. During the intervening period between 04/05/2024 and 08/05/2024, the audited financial statements and audit report were not issued to anybody. The management requested the auditor to consider the situation and issue a fresh audit report on the financial statements for the year ended 31/03/2024.

Aadhya Ltd. recently declared and paid an annual dividend of ₹ 5 per share for the most recent financial year, reflecting its commitment to returning value to shareholders. According to management's guidance, the dividend is expected to experience a robust growth rate of 18% per annum over the next two years, signaling confidence in the company's near-term financial performance and expansion potential. Beyond this period, the growth rate is projected to moderate to a more sustainable 8% per annum indefinitely. With the required rate of return for equity investors in Aadhya Ltd. set at 14%, the company's dividend strategy plays a crucial role in shaping investor expectations and valuation considerations, providing a balanced outlook between short-term growth and long-term stability.

Aadhya Ltd.

Organizational Structure



I. Multiple Choice Questions

8.1 Aadhya Foundation is applying the Value for Money (VFM) framework to enhance its programs. Which of the following actions best balances the principles of effectiveness, efficiency, and economy?

(a) The Foundation implements AI to automate patient record-keeping and optimize hospital workflows, resulting in improved care delivery. It also continuously tracks patient recovery rates and uses this data to adjust its healthcare strategies. In addition, the Foundation ensures that it secures quality supplies at competitive rates after comparing several vendors.

(b) The Foundation partners with Aadhya Ltd.'s R&D team to deploy IoT-enabled tracking systems in its disaster relief supply chains. These systems improve real-time monitoring of resource usage and minimize wastage, while data-driven insights are used to enhance service delivery efficiency, even if it involves higher initial investment.

(c) Aadhya Ltd. launches a new blockchain-powered solution to manage the Foundation's financial aid programs, prioritizing faster transaction times, but without adequately monitored for potential errors in fund distribution.

(d) The Foundation expands its skills training programs by focusing on providing courses in emerging technologies like Blockchain, increasing the number of participants, while delaying the introduction of performance metrics to track how many trainees benefited in the long run.

8.2 Based on the transaction described in the case study, what should be the value of the goods supplied by Aadhya Ltd. to XYZ Traders?

(a) ₹ 2,52,000

(b) ₹ 2,95,000

(c) ₹ 2,97,360

(d) ₹ 2,50,000

8.3 The intrinsic value of Aadhya Ltd.'s equity shares using the two-stage dividend growth model shall be approximately _____.

Note: Use PVF up to 4 decimal points.

(a) ₹ 106.98

(b) ₹ 105.57

(c) ₹ 107.34

(d) ₹ 104.98

8.4 Evaluate the status of petition filed by the group of members of Aadhya Ltd., holding 12% of the company's issued share capital in contention in light of the Companies Act, 2013.

(a) The petition must be dismissed as the petitioners no longer meet the minimum shareholding requirement.

(b) The proceedings shall continue irrespective of the withdrawal of consent by some petitioners.

(c) The Tribunal must consider the current shareholding percentage of the petitioners before making a decision.

(d) The petitioners must file a new petition reflecting the current shareholding situation.

8.5 DRT & Co. knew they had to thoroughly validate the existence and valuation of the significant liability (M/s Builders Corp.) as on March 31, 2024. But which audit procedure would yield the most reliable evidence?

(a) Inspect each and every journal entry passed in Aadhya Ltd.'s books

(b) Ask Aadhya Ltd. to provide the details of payments made to vendors during the year

(c) Inspect the invoices issued by M/s Builders Corp. and the related payments made

(d) Interrogate Aadhya Ltd.'s cash management team

II. Descriptive Questions

8.6 RECOMMEND how the discontinued operation pertaining to Suraksha Constructions was measured and presented in Aadhya Ltd.'s consolidated financial statements:

1. On the **acquisition date**.
2. On the **reporting date** of the divestment.

8.7. (a) In light of the tenets of corporate governance and shareholder rights enshrined in the Companies Act, 2013, evaluate whether Aadhya Ltd.'s decision to deny Rajveer access to Vihaan's contract was justified. Substantiate your answer with relevant provisions of the Act and principles of transparency and disclosure that a company like Aadhya Ltd. should uphold.

(b) In the context of the two loan proposals by K. Ahuja and Bharat Mehta, analyze the legal permissibility and conditions under the Companies Act, 2013 for a company to grant such loans to its directors.

8.8. With reference to the information given in the case study, analyze the issues involved and give your views as to whether or not the auditor, DRT & Co., could accept the request of the management.

8.9 Considering the import transaction, what would have been the most likely recommendation made by the finance team to Vihaan Mehta during the meeting? (Assume 360 days in a year)

ANSWERS TO THE CASE STUDY 8

I. Answers to the Multiple Choice Questions

8.1 (a) The Foundation implements AI to automate patient record-keeping and optimize hospital workflows, resulting in improved care delivery. It also continuously tracks patient recovery rates and uses this data to adjust its healthcare strategies. In addition, the Foundation ensures that it secures quality supplies at competitive rates after comparing several vendors.

Reason:

Option (a) illustrates a balanced approach to the VFM framework by addressing **effectiveness** through the use of AI for improved care delivery and patient tracking, ensuring the foundation meets its healthcare objectives. It also incorporates **efficiency** by optimizing workflows and **economy** by securing quality supplies at competitive rates. In contrast, option (b) focuses on efficiency and effectiveness but involves higher costs without clear long-term economic benefits. Option (c) prioritizes speed but neglects monitoring, risking errors. Option (d) increases participation without assessing long-term

effectiveness, compromising the foundational aim of sustainable outcomes.

8.2 (a) ₹ 2,52,000

Reason: In the given case, price is not the sole consideration for the supply. Apart from monetary consideration, the buyer has given some material to the supplier as consideration for such supply. Hence, the value of the supply cannot be determined on the basis of the transaction value in terms of section 15(1) of the CGST Act, 2017. Here, the value will be determined with the help of rule 27 of the CGST Rules, 2017 which specifies that where the consideration for a supply is not wholly in money, the value will be the open market value. Open market value of a supply means the full value in money, excluding the applicable GST, where the supplier and the recipient of the supply are not related and the price is the sole consideration, to obtain such supply at the same time when the supply being valued is made. Therefore, in the given case, the open market value of the goods supplied is ₹ 2,52,000 (₹ 2,97,360 x 100/118) and is therefore, the value of such goods.

8.3 (a) ₹ 106.98

Reason:

D_o = ₹5

D_1 = ₹5 (1.18) = ₹5.90

D_2 = ₹5 $(1.18)^2$ = ₹6.96

D_3 = ₹5 $(1.18)^2$ (1.08) = ₹7.52

$P = D_1/(1+k_e) + D_2/(1+k_e)^2 + TV/(1+k_e)^2$

$TV = D_3/(k_e-g)$

$= 7.52/(0.14-0.8)$

$= 125.33$

$P = 5.90/(1+0.14) + 6.96/(1+0.14)^2 + 125.33/(1+0.14)^2$

$= 5.90 \times 0.8772 + 6.96 \times 0.7695 + 125.33 \times 0.7695$

$= 5.18+5.36+96.44$

$= 106.98$

8.4 (b) The proceedings shall continue irrespective of the withdrawal of consent by some petitioners.

Reason: The proceedings shall continue irrespective of withdrawal of consent by some petitioners. It has been held by the Supreme Court in Rajmundhry Electric Corporation vs. V. Nageswar Rao, AIR (1956) SC 213 that if some of the consenting members have subsequent to the presentation of the petition withdraw their consent, it would not affect the right of the applicant to proceed with the petition. Thus, the validity of the petition must be judged on the facts as they were at the time of presentation. Neither the right of the applicants to proceed with the petition nor the jurisdiction of the Tribunal to dispose of it on its merits can be affected by events happening subsequent to the presentation of the petition.

8.5 (c) Inspect the invoices issued by M/s Builders Corp and the related payments made.

Reason: By scrutinizing the original invoices and cross-verifying the payment trails, auditors could obtain direct evidence validating the existence and accurate valuation of this key accounts payable component in Aadhya Ltd.'s books as on the balance sheet date.

II. Answers to the Descriptive Questions

8.6 Guidance from standard: Ind AS 105 defines a disposal group as a group of assets to be disposed of, by sale or otherwise, together as a group in a single transaction, alongwith liabilities directly associated with those assets that will be transferred in the transaction. The group includes goodwill acquired in a business combination if the group is a cash-generating unit to which goodwill has been allocated in accordance with the requirements of paragraphs 80-87 of Ind AS 36, Impairment of Assets, or if it is an operation within such a cash-generating unit.

Analysis and Conclusion: In the given case, Suraksha Constructions was acquired exclusively with a view to sell. Hence, it meets the criteria to be classified as a discontinued operation.

The discontinued operation would be measured in accordance with paragraphs 15 and 16 of Ind AS 105.

- As per para 15, an entity shall measure a non-current asset (or disposal group) classified as held for sale at the lower of its carrying amount and fair value less costs to sell.
- As per para 16, if a newly acquired asset (or disposal group) meets the criteria to be classified as held for sale (see paragraph 11), applying paragraph 15 will result in the asset (or disposal group) being measured on initial recognition at the lower of its carrying amount had it not been so classified (for example, cost) and fair value less costs to sell. Hence, if the asset (or disposal group) is acquired as part of a business combination, it shall be measured at fair value less costs to sell.

Therefore, **on acquisition date**, in line with paragraph 16, Aadhya Ltd. would have measured Suraksha Constructions as a disposal group at fair value less costs to sell which would have been calculated by Adhya Ltd. as:

- Fair value of total assets excluding liabilities on acquisition – Costs to sell = ₹ 3,060 Crores - ₹ 48 Crores = ₹ 3,012 Crores.
- Fair value of liabilities on acquisition= ₹ 510 Crores.

At the reporting date, in line with paragraph 15, Aadhya Ltd. would have remeasured the disposal group at the lower of its cost and fair value less costs to sell, which would have been calculated by Adhya Ltd. as:

- Fair value of total assets excluding liabilities on subsequent reporting date – Costs to sell = ₹ 3,000 Crores -₹ 48 Crores = ₹ 2,952 Crores
- Fair value of liabilities on reporting date = ₹ 528 Crores.

At the reporting date, Aadhya Ltd. would have presented these assets and liabilities separately from other assets and liabilities in its consolidated financial statements.

In the statement of profit and loss, Aadhya Ltd. would have recognized loss on subsequent measurement to fair value less cost to sale of the disposal group i.e. Suraksha Constructions, which equals ₹ 60 crores (₹ 3,060 Crores - ₹ 3,000 Crores).

8.7 (a) No, the company's decision to deny Rajveer Bhatia access to Vihaan's remuneration details was likely not justified.

Section 197(4) expressly requires that the remuneration payable to the directors of a company, including any managing or whole-time director or manager, shall be determined, in accordance with and subject to the provisions of Section 197 of the Companies Act, 2013. Determination of Remuneration can be made either by the articles or by a resolution or if the articles so require, by a special resolution passed by the company in general meeting. The remuneration so determined to be payable is required to be inclusive of the remuneration payable to him for the services rendered by any such director in any other capacity.

As per Section 171(1) of the Companies Act, 2013:

(1) register of directors and key managerial personnel of the company

(A) Shall be open for inspection during business hours and the members shall have a right to take extracts therefrom and copies thereof, on a request by the members, be provided to them free of cost within thirty days; and

(B) Shall also be kept open for inspection at every annual general meeting of the company and shall be made accessible to any person attending the meeting.

Even though a written contract might not exist, the company should still be able to provide details on Vihaan's remuneration package. This could include information like salary, benefits, stock options, and performance-based bonuses.

In conclusion, the company's decision to deny access without proper explanation is likely questionable. Transparency is crucial for maintaining good corporate governance, and shareholders have the right to be informed about such matters.

(b) Section 185 of the Companies Act, 2013 contains provisions which impose restrictions on the loans, etc. being given to directors, etc. According to the provision:

As per sub-section (1), a company is not permitted to advance any loan, or to give any guarantee or provide any security in connection with any loan taken by, -

(i) any director of company, or of a company which is its holding company or any partner or relative of any such director; or

(ii) any firm in which any such director or relative is a partner.

Further sub-section (3) states that above provision shall not apply:

(a) where any loan is given to a managing or whole-time director-

(i) as a part of the conditions of service extended by the company to all its employees; or

(ii) pursuant to any such scheme which is approved by the members by a special resolution.

(b) where a company in the ordinary course of its business:

- provides loans or gives guarantees or securities for the due repayment of any loan; and
- In respect of such loans an interest is charged at a rate not less than the rate of prevailing yield of one year, three years, five years or ten years Government security closest to the tenor of the loan.

Accordingly, following are the answers to the stated problems:

(i) In the first case it would violate section 185(1) of the Companies Act, 2013. Aadhya Ltd. is not permitted to advance any loan, or to give any guarantee or provide any security in connection with any loan taken by K. Ahuja (director) of the company.

(ii) In the second case, as per section 185(3), restrictions imposed in section 185(1), will not apply to giving of loan to Bharat Mehta, the whole-time director if it is given as a part of the conditions of service extended by the company to all its employees.

8.8 Facts which become known to the auditor after the date of the auditor's report but before the date the financial statements are issued:

As per SA 560, "Subsequent Events", the auditor has no obligation to perform any audit procedures regarding the financial statements after

the date of the auditor's report. However, when, after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall:

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

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

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

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

In the instant case, Aadhya Ltd. received an amount of ₹ 20 crore on account incentives pertaining to the year 2023-24 in the month of May 2024 i.e. after finalization of financial statements and signing of audit reports. The management of Aadhya Ltd. amended the accounts, approved the same and requested DRT & Co. (auditor) to consider this event and issue a fresh audit report on the financial statements for the year ended on 31.03.2024.

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

8.9 Possible Options are as under:

(i) Pay the supplier in 60 days

If the payment is made to supplier in 60 days, the applicable forward rate for 1 USD	₹ 84.10
Payment Due	USD 20,00,000

Outflow in Rupees (USD 2,000,000 × ₹ 84.10)	₹ 16,82,00,000
Add: Interest on loan for 30 days @10% p.a.	₹ 14,01,667
Total Outflow in ₹	**₹ 16,96,01,667**

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

Amount Payable	USD 20,00,000
Add: Interest on credit period for 30 days @8% p.a.	USD 13,333
Total Outflow in USD	USD 20,13,333
Applicable forward rate for 1 USD	₹ 84.50
Total Outflow in ₹ (USD 2,013,333 × ₹ 84.50)	**₹ 17,01,26,639**

Alternative 1 is better as it entails lower cash outflow.

CASE STUDY 9

CA. Radhika Sharma is an audit partner in L & V LLP, a firm of Chartered Accountants. The Firm was founded by CA. Lata Subramanian in 1960. With a strong legacy of spanning over multiple decades and its humble origins in the steel city of Jamshedpur, the Firm has established offices across key cities in India. The firm caters to clients across diverse market segments including industrial markets, infrastructure, consumer products, financial services, technology and telecommunications.

CA. Radhika was waiting at the Mumbai office to meet CA. Archana Kumari, a Fellow Chartered Accountant. CA. Archana had been appointed by a competent authority to inspect and evaluate adherence to SQC-1 and review selected audit documentations in relation to statutory audit of the financial statements for the year ended 31 March 2023, conducted by L & V LLP for a listed entity. The review focused on three significant audit areas—Revenue, Trade Receivables, and Investments—due to their inherent higher risk of material misstatement in the audit engagement.

The receptionist informed CA. Radhika about the arrival of CA. Archana. Both of them exchanged pleasantries and CA. Archana was guided into a pre-booked meeting room. CA. Archana requested for the audit files for initiating audit inspection. CA. Radhika explained that the audit documents are maintained electronically. For ease of review, the archived version of the audit file has been hosted on the laptop of the firm. CA. Archana explained that she would need some time to understand the policies of L & V and discuss her initial observations. At the end of the day, following discussions took place:

CA. Archana: *Can you tell me about the service offerings of the firm? Does it also provide advisory services?*

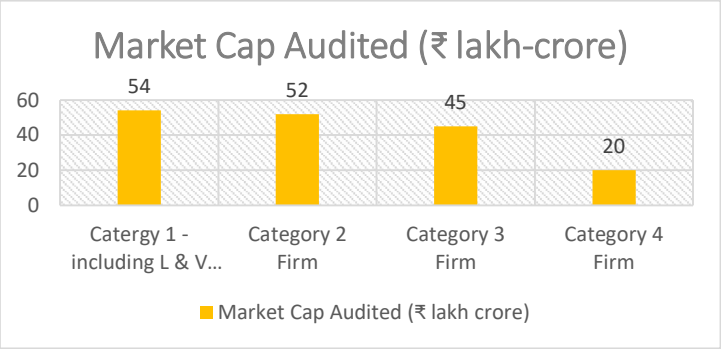
CA. Radhika: *We are a multidisciplinary firm providing a wide array of services. Our service offerings can be bifurcated between:*



Audit and Assurance

Audits are the fundamental building blocks of effective capital markets. Auditors use their knowledge, skills and experience to deliver high-quality audits with independence, integrity, objectivity and professional skepticism. In doing so, they help to support sustainable, long-term value creation. High-quality audits facilitate economic growth and enhance trust and confidence in business and the capital markets. More than 1,500 audit professionals support the delivery of data-driven audits, powered by leading-edge technology, including foundational audit technologies.

The firm provide consistent audits by assembling the right multidisciplinary teams to address the most complex issues, using a proven audit methodology and deploying the latest, high-quality auditing tools and technologies. The Firm understands that to achieve the desired potential a tailored assurance service as much as a consistent methodology, clients benefit from sector and subject-matter knowledge is provided.





Tax services

The Firm's tax professionals offer services across all tax disciplines to help thrive in this era of rapid change. The coordinated tax professionals offer connected services across all tax disciplines to help the entities thrive in an era of rapid change. The Firm combine its exceptional knowledge and experience with the people and technology platforms that make us an ideal partner for tax-related needs. The Firm has competencies in business tax, international tax, transaction tax and tax-related issues, compliance and reporting as well as legal matters.

Complying with the tax laws and regulations that are constantly changing is a challenge. The Firm provides services from tax filing to tax planning. For global businesses, accurate tax compliance is an instrumental piece of the tax puzzle. Getting this piece right is increasingly complicated because of the rapid pace of legislative and regulatory change, and the increasing digitalization of revenue authorities. Additionally, staying current on tax developments at the local and national level, while meeting the demands needed for more transparency and financial information, strains the resources of tax departments and further complicates tax compliance.



Advisory at the Firm helps in realizing business transformation through the power of people, technology and innovation. Faced with an increasingly complex and uncertain operating environment, organizations — and the people within them — are under pressure to make

Advisory services	*decisions better, faster, and smarter. Yet, as stakeholder expectations shift, and as technology advances, new ways of working and regulatory change are making it harder for people to make the right decisions.* *To further support clients, the Firm provides business strategy consulting, utilizing frameworks such as the Boston Consulting Group (BCG) Matrix and McKinsey's 7S model. Our diversified services in business strategy help organizations assess market positions, allocate resources efficiently, and devise competitive strategies for sustained growth. By leveraging strategic tools like these, the Firm enables businesses to build resilient, scalable models that adapt to changing environments while driving long-term value creation.* *In addition, the firm offers bookkeeping service as well. Our bookkeeping services ensures the integrity of transactions and company data. Hence, it requires experienced and skilled professionals, who hold deep knowledge of the subject. Our services help businesses streamline activities, make better business decisions, decrease execution costs, reduce time spend, and manage budget whenever necessary.*

CA. Archana: *That's interesting. But how do you ensure that no independence conflict arise while accepting/ performing an audit engagement? If there is an independence policy, can you please share a copy of such policy?*

CA. Radhika: *If you browse to the client acceptance section of the electronic audit file, we have documented our independence policy. In a nutshell, our independence policy is based on the requirements of SQC 1 as issued by the ICAI. As per SQC 1, the firm has established policies and procedures designed to provide it with reasonable assurance that the firm, its personnel and, where applicable, others subject to independence requirements, maintain independence where required by the ICAI's Code of Conduct. Accordingly, the firm is able to identify and evaluate circumstances and relationships that create threats to independence, and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the engagement. The Code*

also require us to consider the requirements of applicable laws and regulations e.g. the Companies Act, 2013.

CA. Archana: *Great. I would go through the independence policy in detail. Was any breach of independence requirements were observed for the engagement under inspection?*

CA. Radhika: *No breach of independence was observed. We have a close relationship with the audit client. During the last year due to high level of attrition the client approached us to help in preparing the financial statements– which the Firm decided to support. A team (separate from the audit team) was formed to avoid any independence threat.*

CA. Archana: *Considering the engagement under discussion is in industrial equipment segment, did you involve an engagement control quality reviewer ('EQCR') for this engagement?*

CA. Radhika: *It is essential that the quality of our work is of the highest standard. One of the ways in which we seek to achieve this high standard is through engagement quality control reviews. The objective of such review is to provide an objective evaluation, on or before the date of the engagement report, of the significant judgments the engagement team made, and the conclusions reached thereon. Pursuant to our quality management and risk management policies, we have appointed Mr. Qureshi as the EQCR for this engagement.*

CA. Archana: *I am not too sure about the skill and experience of the EQCR. Could you please elaborate about his experience?*

CA. Radhika: *Please be rest assured, the EQCR involved in this engagement is very experienced in accounting and audit. He leads the banking and financial services audit practice. He is a member of the ICAI and have over 30 years of experience in statutory audits, financial accounting advisory and accounting due diligence services relating to financial service sector. We have extensively leveraged his vast experience in all aspects of audit. He has also made decisions for the engagement team.*

CA. Archana: *Could you please elaborate about the revenue recognition policy of the entity under discussion?*

CA. Radhika: *Revenue is recognised as per the relevant Ind AS when control of the goods or services are transferred to the customer at an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. For example,*

revenue from sale of equipment is recognised at the point in time when control of the asset is transferred to the customer, generally on delivery of the equipment. The company has generally concluded that it is the principal in its revenue arrangements, because it typically controls the goods or services before transferring them to the customer. The normal credit term is 30 to 90 days upon delivery. The company considers whether there are other promises in the contract that are separate performance obligations to which a portion of the transaction price needs to be allocated (e.g., warranties, customer loyalty points). In determining the transaction price for the sale of equipment, the company considers the effects of variable consideration, the existence of significant financing components, non-cash consideration, and consideration payable to the customer (if any).

CA. Archana: *I was inclined to ask you about the revenue transaction with Customer P. I could see you concluded that the revenue recognition was appropriate, but it required exercise of significant judgement. Please explain this transaction.*

CA. Radhika: *The company had a Customer P which was undergoing restructuring due to issues related to liquidity. The company has decided not to do any further business with Customer P. The customer has informed that it will provide Letter of Credit from a nationalised bank against which the company can despatch goods. Company has manufactured the goods exclusively for Customer P, but the Letter of Credit was not yet arranged because it was in process till the date of our audit report. However, basis the past experience of no default by Customer P, the company recognised revenue.*

CA. Archana: *A qualified audit opinion was issued in the current year due to the inability to comment recoverability of the company's investment in subsidiaries. Could you please explain the rational for the same?*

CA. Radhika: *The qualification was limited only to the investments of the company in one subsidiary. It does not have an impact on the recoverability of the outstanding loans given to the subsidiary. Since the undetected misstatements were limited to specific investments, in absence of sufficient appropriate audit evidence, there is no pervasive impact as per the requirements of the SA 705 and accordingly a qualified opinion was appropriate.*

CA. Archana: *In how many days was the electronic audit file assembled?*

CA. Radhika: *The firm has established policies and procedures for engagement teams to complete the assembly of final engagement files on a timely basis after the engagement reports have been finalized. In the case of an audit the time limit is ordinarily not more than 65 days after the date of the auditor's report.*

Post completion of discussion, CA. Archana continued to review the electronic file till next week. Multiple rounds of discussions were held between CA. Radhika and CA. Archana. On the last working day, CA. Archana set up a meeting to discuss the findings of the draft inspection report. **Excerpt of the draft inspection report is enclosed as Annexure**.

Simultaneously, a business review meeting was held by the firm's partners to evaluate the firm's operations and to assess the potential implications if the firm were to cease providing bookkeeping services, given the concerns highlighted in the draft inspection report. The bookkeeping division (under advisory services), launched in November 2014, initially expanded rapidly, growing to about 50 locations within three years, primarily in metro cities. However, this rapid expansion exposed weaknesses in the division's systems and infrastructure, which were unable to support such growth. As a result, the Firm encountered operational difficulties.

The bookkeeping services offer low-margin services while facing high operational costs, including rent and payroll. These challenges were further exacerbated by issues like high staff attrition, supply-chain inefficiencies, and infrastructure limitations. Consequently, the division was forced to close nearly 10 offices within two years of its launch. In response to these challenges, the bookkeeping division has since standardized its operations, streamlined processes, and centralized its supply chain to improve efficiency.

Despite providing a comprehensive range of boutique services under one roof—offering a broader portfolio than many local advisory firms—L & V LLP struggles to compete effectively with smaller, politically connected local advisory firms – who are not a firm of Chartered Accountants. These local advisory firms often offer limited but highly competitive services, particularly in terms of pricing. In 2016, L & V LLP faced significant setbacks when it was forced out of several profitable regions due to intense opposition from small, locally connected firms, highlighting the challenges posed by local competition.

One of the key issues L & V LLP faces is the uneven pricing structure among local advisory firms. Although L & V LLP offers its services at comparable prices, and provides a superior quality of service, local businesses frequently prefer to work with local firms, valuing proximity and political ties over service quality.

Moreover, the bookkeeping division requires continuous investment, yet it lacks strategic synergy with the firm's broader activities. The division continues to incur losses despite the improvements in operations. For the firm to achieve its expansion goals and maintain profitability across all offices, it must rethink its strategy. The aim is to ensure that every office not only sustains itself but also contributes to the overall profitability of the firm, which is crucial for scaling the business in a sustainable way. The firm is contemplating various strategic measures including establishment of a Centre of Excellence.

ANNEXURE

Excerpt of the Draft Inspection Report

Review of Firm-vide Audit Quality Control System

- The firm has formulated an EQCR policy which inter-alia requires EQCR in audit of listed entities. Such review was conducted in a timely manner at appropriate stages during the engagement so that significant matters may be promptly resolved to the reviewer's satisfaction before the report is issued. However, the firm's policies and procedures on appointment of engagement quality control reviewers and their eligibility conditions are not in line with SQC 1. In the extant case, EQCR has experience in audit of banking and financial services entities and did not possess experience in the sector where the entity belongs (i.e. industrial equipment sector). Also, the EQCR's involvement in making decisions for the engagement team is also not in line with SQC 1.
- The firm has established policies and procedures for engagement teams to complete the assembly of final engagement files on a timely basis after the engagement reports have been finalized. The audit report was signed on 15 May 2023. At present the assembly period is maximum of 65 days from the date of the audit report and accordingly the electronic audit file was assembled on 19 July 2023. The extant archival policy of the firm is not aligned with the requirements of SQC 1.

Independence threat

- The firm's independence policy does not restrict rendition of non-audit services that are prohibited under ICAI's Code of Ethics. For instance, the independence policy of the firm does not prohibit the rendering of bookkeeping services to the audit client. We observe that the firm has prepared the financial statements of the audit client by forming a separate team of professionals (other than the audit team professional). This tantamount to providing bookkeeping services to the listed company. However, such service cannot be provided to the listed company as per ICAI' Code of Ethics. The firm

is advised to create a negative list, which should, at a minimum, cover the services prohibited under the ICAI's Code of Ethics, and appoint an Independence and Ethics Partner.

Failure to consider 'Material and Pervasive' impacts of misstatements while expressing audit opinion on the financial statements

- The firm expressed a qualified audit opinion due to its inability to comment upon recoverability of the company's investments in the subsidiary. However, the audit firm did not consider other financial exposures - which were in the form of the loans. It is quite obvious that a doubt on recoverability of investment equally creates doubt on recovery of loans given to subsidiary. Accordingly, the basic premise of focusing solely on investments and not considering the total financial exposure to the subsidiary is fundamentally flawed. The total financial exposure, including investments in the subsidiary, represented 60% of the company's total net worth at the year-end. A very high-level estimate performed indicated a possible reduction in profit before tax by 70% as impairment indicators exist as at the year end.
- The rational documented by the engagement partner is inappropriate since the engagement partner failed to consider the total exposure of the company in its subsidiary, while evaluating the possible effects of undetected misstatements on the financial statements. There is no explanation for how the engagement concluded that there was no impact on the recoverability of the loans given to the subsidiary. The firm's contention that since such undetected misstatements were limited to specific investments, there is no pervasive impact (as per the requirements of SA 705), is not satisfactory.

Unapproved related party transactions not considered while forming the audit opinion

During the year the listed company purchased goods amounting to ₹150 crores from related parties as defined under the Companies Act, 2013. Turnover for the year amount to ₹1,300 crores. Under Section 188 of the Companies Act, 2013, shareholders' approval is required if purchases of goods from related party exceeds 10% of the turnover of the year – in the extant case it amounts to 12%. The electronic audit file simply states that the transactions are at arm's length and in the ordinary course of business. No detailed assessment is included. Considering non-compliance of the Companies Act, 2013, the audit opinion should have been modified in respect of this matter.

I. Multiple Choice Questions

9.1 Do you agree with CA. Archana's findings related to the EQCR? Choose the correct statement.

(a) **No.** The observation is incorrect, as an EQCR is not required to be assigned for audits of listed entities unless specifically mandated by the engagement's complexity or regulatory body.

(b) **Yes.** Mr. Qureshi does not possess the necessary sectoral experience and knowledge to perform the EQCR role

effectively, and under SQC 1, he cannot make decisions for the engagement team.

(c) **Yes.** Mr. Qureshi does not possess sectoral experience and technical knowledge, which disqualifies him from being an EQCR as per SQC 1, but he may still support the engagement in a limited capacity.

(d) **No.** An individual can be appointed as an EQCR for multiple audit engagements, even in cases where they do not possess specific sectoral knowledge, as long as they fulfil other technical qualifications under SQC 1.

9.2 In accordance with SQC 1 and SA 230, the audit firm should have completed the assembly of final audit files by-

(a) **13 August 2023** – The firm is allowed total 90 days from the audit report date (including extended time (of 30 days) to accommodate additional reviews and documentation for complex audits, in line with regulatory flexibility for listed entities as permitted under SQC 1.

(b) **24 July 2023** – SQC 1 and SA 230 set a standard time limit of 60 days but allow for a flexibility of up to 10 additional days for firms auditing multiple subsidiaries, provided that sufficient documentation justifies the extension.

(c) **3 August 2023** – Certain international regulatory frameworks permit an additional 20 days beyond the standard time limit of 60 days prescribed under SQC 1 to address complexities arising from cross-border audit engagements.

(d) **14 July 2023** – SQC 1 requires audit firms to establish policies for the timely completion of audit files, and as per SA 230, this should ordinarily be no more than 60 days after the auditor's report date.

9.3 The threat to auditors independence identified in the inspection report represents_____.

(a) **Self-review threat.** The Firm will not appropriately evaluate the results of an activity performed by an individual within the firm as part of a non-audit service on which the audit team will rely when forming a judgment as part of an audit.

(b) **Self-interest threat.** Financial interest will inappropriately influence auditor's judgment or behaviour.

(c) **Advocacy threat .** Auditor will promote the Company's position to the point that his/ her objectivity is compromised.

(d) **Familiarity threat.** Due to a long or close relationship with the Company, the auditor will be too sympathetic to their interests or too accepting of their work.

9.4 Considering non-availability of audit evidence, CA. Radhika should have issued _____?

(a) Adverse audit opinion

(b) Disclaimer of audit opinion

(c) Unmodified audit opinion with an emphasis of matter paragraph

(d) Adverse audit opinion on the investment and disclaimer of audit opinion on the remaining portion of the financial statements

9.5 Do you agree with CA. Radhika's observation relating to related party transactions?

(a) **No**. Companies Act, 2013 requirements do not apply to an listed entity if they are conflict with SEBI Listing Regulations. SEBI Listing Regulations do not mandate shareholder approval

(b) **No.** Section 188 do not cover routine transactions like purchase of goods

(c) **No.** Shareholders' approval under section 188 is not triggered if the transaction is at arm's length.

(d) **No.** Shareholders' approval under section 188 is not required if the transaction is at arm's length and at ordinary course of business.

II. Descriptive Questions

9.6 When should revenue from the Customer P be recognised by the Company?

9.7 RECOMMEND the strategic measures L & V LLP can implement to enhance the profitability and competitiveness of its bookkeeping

division, considering internal inefficiencies, external market challenges, and the establishment of a Centre of Excellence.

9.8 In light of the Ms. Archana's observation RE-DRAFT a policy to identify and evaluate possible threats to independence considering SQC 1?

ANSWERS TO THE CASE STUDY 9

I. Answers to the Multiple Choice Questions

9.1 (b) **Yes.** Mr. Qureshi does not possess the necessary sectoral experience and knowledge to perform the EQCR role effectively, and under SQC 1, he cannot make decisions for the engagement team.

Reason: Under paragraph 68 of SQC 1 the firm's policies and procedures should address the appointment of EQCRs and establish their eligibility through technical qualifications required to perform the role, including the necessary experience and authority. Also, as per paragraph 70 of SQC 1 an EQCR does not make decisions for the engagement team.

9.2 (d) **14 July 2023** – SQC 1 requires audit firms to establish policies for the timely completion of audit files, and as per SA 230, this should ordinarily be no more than 60 days after the auditor's report date.

Reason: SQC 1 requires firms to establish policies and procedures for the timely completion of the assembly of audit files.

As per paragraph A21 of SA 230, an appropriate time limit within which to complete the assembly of the final audit file is ordinarily not more than 60 days after the date of the auditor's report.

9.3 (a) **Self-review threat.** The Firm will not appropriately evaluate the results of an activity performed by an individual within the firm as part of a non-audit service on which the audit team will rely when forming a judgment as part of an audit.

Reason: Under ICAI's Code of Ethics providing accounting and bookkeeping services to an audit client create a self-review threat. As per the provisions of the Guidance Note on

Independence of Auditors, it is not permitted to do the book keeping work of the auditee client.

9.4 (b) Disclaimer of audit opinion

Reason: The implication arising due to non-availability of information relating to recovery of total financial exposure can possibly have a pervasive effect on the financial statements.

SA 705 defines pervasiveness as follows:

Pervasive – A term used, in the context of misstatements, to describe the effects on the financial statements of misstatements or the possible effects on the financial statements of misstatements, if any, that are undetected due to an inability to obtain sufficient appropriate audit evidence. Pervasive effects on the financial statements are those that, in the auditor's judgment:

(i) Are not confined to specific elements, accounts or items of the financial statements;

(ii) If so confined, represent or could represent a substantial proportion of the financial statements; *or*

(iii) In relation to disclosures, are fundamental to users' understanding of the financial statements.

Since the total financial exposure, including investments in the subsidiary, represented 60% of the company's total net worth at the year-end and a possible reduction of 70% of profit before tax (basis high level estimate), the impact can be pervasive. Accordingly, as per SA 705, disclaimer of opinion should have been issued by CA. Radhika Sharma.

9.5 (d) **No.** Shareholders' approval under section 188 is not required if the transaction is at arm's length and at ordinary course of business.

Reason: First proviso to Section 188(1) of the Companies Act, 2013 interalia require companies to obtain shareholder approval if the prescribed threshold is met. However, fourth proviso to section 188(1) state that the requirements of section 188(1) including proviso do not apply to any transactions entered into by the company in its ordinary course of business other than transactions which are not on an arm's length basis.

II. Answers to the Descriptive Questions

9.6 As per paragraph 9 of Ind AS 115, "An entity shall account for a contract with a customer that is within the scope of this Standard only when all of the following criteria are met:

(a) the parties to the contract have approved the contract (in writing, orally or in accordance with other customary business practices) and are committed to perform their respective obligations;

(b) the entity can identify each party's rights regarding the goods or services to be transferred;

(c) the entity can identify the payment terms for the goods or services to be transferred;

(d) the contract has commercial substance (i.e. the risk, timing or amount of the entity's future cash flows is expected to change as a result of the contract); and

(e) it is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer. In evaluating whether collectability of an amount of consideration is probable, an entity shall consider only the customer's ability and intention to pay that amount of consideration when it is due. The amount of consideration to which the entity will be entitled may be less than the price stated in the contract if the consideration is variable because the entity may offer the customer a price concession".

Paragraph 9(e) above, requires that for revenue to be recognised, it should be probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer.

In the given case, as the customer has liquidity issues, the collection is not considered to be probable. Accordingly, till the time the Letter of Credit (LoC) is arranged from a nationalised bank, criterion as mentioned in paragraph 9(e) is not met. Hence, revenue recognition from sale to customer P should be deferred till receipt of LoC.

9.7 To enhance the profitability and competitiveness of the bookkeeping division at L & V LLP, the firm must address both internal inefficiencies and external market challenges. Here are strategic recommendations based on the analysis provided:

Analyse the Value Chain

To enhance profitability and operational efficiency, the firm should analyse its value chain thoroughly. By *optimizing key activities* such as client engagement, service delivery, and reporting, the firm can improve the quality of its offerings. This could involve establishing *stronger communication and collaboration between departments* to ensure that resources are used effectively and aligned with client needs.

Addressing Buyer Power

Currently, local firms have an advantage because they allow clients to negotiate prices, whereas L & V LLP offers fixed-price services.

To address this, the firm could offer customized pricing based on client size, volume of transactions, or complexity of work. For example, providing tiered pricing or discounted packages for long-term contracts could help attract *price-sensitive clients*.

In addition, highlight the superior quality of L & V LLP's services in client communications, positioning the firm as a trusted advisor with more to offer than local firms. Educating clients about the long-term benefits of high-quality, error-free bookkeeping could justify a *premium price*.

Create a Centre of Excellence (CoE) and Leverage Local Talent

Establishing a Centre of Excellence would enable the firm to *create a pool of highly skilled professionals* focused on standardizing best practices, improving operational efficiency, and reducing costs across the organization. The CoE can implement standardized operating procedures, ensuring consistency and high-quality output throughout the bookkeeping division, minimizing errors and inefficiencies.

In conjunction with the CoE, the firm should actively participate in placement activities at local colleges to hire skilled but more affordable graduate-level employees for bookkeeping roles. This approach would not only lower staffing costs but also help increase profitability. By providing ongoing professional development,

mentorship, and growth opportunities through the CoE, the firm can foster loyalty, reduce staff attrition, and create a sustainable talent pipeline that aligns with long-term organizational goals.

Market Differentiation and Competitive Positioning

While local clients may initially be drawn to the lower prices of local firms, L & V LLP should focus on *communicating the long-term benefits* of working with a firm that provides higher-quality, more reliable service.

Moreover, rather than competing solely on price, the firm should work on *retaining existing clients by* building strong relationships, offering personalized services, and providing value-added solutions, such as financial reporting, advisory, or tax planning services in addition to bookkeeping.

Streamlined Expansion Strategy

Rather than expanding rapidly into new regions, the firm should focus on *strengthening operations in existing markets* and ensuring each office becomes profitable. Centralized support functions, such as IT and HR, could help standardize processes and reduce overhead costs.

The firm should consider *expanding in regions* where local competition is weaker, focusing on sectors or industries that require more complex, high-quality bookkeeping services. This would help the firm build a *niche presence* and avoid direct competition with local firms.

Conclusion

By addressing inefficiencies in its value chain, adopting more flexible pricing strategies, leveraging local talent, and enhancing its competitive positioning, L & V LLP can improve the profitability of its bookkeeping division.

9.8 L & V LLP establishes procedures to identify and evaluate possible threats to independence and objectivity, including the familiarity threat that may be created by using the same senior personnel on an audit or attest engagement over a long period of time, and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards. Following is an illustrative

independence policy that may be drafted by L & V LLP considering the requirements of SQC 1:

- *Requiring the **engagement partner to provide relevant information about client engagements**, including the scope of services, to enable him to evaluate the overall impact, if any, on independence requirements.*
- ***Providing training** to partners and professional staff on what constitutes threats to independence and the nature of safeguards that may be taken to eliminate or reduce the threats to an acceptable level. Such training should include ICAI's responses to matters dealing with ethical conduct.*
- ***Accumulating and communicating relevant information to appropriate personnel** so that the following can occur:*
  - *The firm, the engagement partner, firm personnel and others, if any, can readily determine whether they satisfy independence requirements.*
  - *The firm can maintain and update information relating to independence.*
  - *The firm and the engagement partner can take appropriate action regarding identified threats to independence, in consultation with the independence and ethics partner.*
- *Requiring personnel to **promptly report** circumstances and relationships that create a threat to independence and independence breaches of which they become aware to the independence and ethics partner so that appropriate action can be taken.*
- *Establishing criteria to determine the **need for safeguards for engagements** where the following have taken place:*
  - *The firm's monitoring procedures or peer review has identified weaknesses in previous years.*
  - *The same senior personnel have been used for five years or more on an audit or attestation engagement.*

- *The client pressurizes the engagement partner to take a particular position or an accounting or auditing issue.*

▪ ***Promptly communicating identified breaches of these policies and procedures**, and the required corrective actions, to the following personnel:*

- *The engagement partner who, with the firm, needs to address the breach.*
- *The independence and ethics partner who should report the breaches to the managing partner for necessary action.*
- *Other relevant personnel in the Firm and those subject to the independence requirements who need to take appropriate action.*

▪ *Requiring the engagement partner and the other individuals referred to in the previous list to confirm to the firm that the required **corrective actions** have been taken.*

▪ *Having the independence and ethics partner, or an individual designated by him, periodically review unpaid fees from clients to ascertain whether any outstanding amounts impair the firm's independence.*

▪ *Establishing additional procedures that provide safeguards when the firm performs audit or other attest work for a) significant clients or b) clients at which partners or other senior personnel are offered key management positions or have accepted offers of employment.*

▪ *Documenting the threats and the safeguards applied to eliminate or reduce them to an acceptable level for each instance.*

CASE STUDY 10

Mr. Aditya: From Corporate Professional to Entrepreneur

Before founding Sprinter Private Limited, Mr. Aditya P. had a distinguished career in the textile industry, working for over two decades in a leading multinational corporation. Starting as an entry-level employee, he rose through the ranks due to his expertise in manufacturing, international trade, and operational management. His experience gave him deep insights into the textile market, both domestically and globally. With a vision to build a brand of his own and tap into the booming textile exports market, Mr. Aditya ventured into entrepreneurship. He brought with him not just years of industry knowledge but also an entrepreneurial spirit, leading to the incorporation of Sprinter Private Limited in May 2023.

Sprinter Private Limited's Journey

Incorporated in May 2023, Sprinter Private Limited has quickly made significant strides in the textile industry. Headquartered in New Delhi, the company embarked on the construction of a state-of-the-art factory building in NOIDA using prefabricated structure, which is common and prevalent in modern times. The building, comprising about 1,00,000 square ft. of covered area, was ready to use by the end of July 2023 at a cost of ₹ 6.50 crores. The company also obtained GST registration the state of Uttar Pradesh in May 2023.

In anticipation of launching production quickly, the company had placed advance orders for new textile machinery from South Korea, costing ₹ 8.65 crores. Additionally, it planned to install previously used indigenous machinery valued at ₹ 2.00 crores. By the first week of August 2023, both imported and indigenous machinery were brought at the NOIDA premises, enabling Sprinter to kick-start commercial production of textile made-ups by September 1, 2023.

The early success of Sprinter's made-up textiles became evident when they quickly gathered attention in the U.S. market. Operating under the "Sprinter" brand, the company skillfully leveraged digital and online marketing platforms to secure export orders, effectively competing with and surpassing Chinese rivals in terms of quality and innovation. The company's strategic focus on digital outreach helped it capture a significant chunk of the export market, further fueling its rapid growth.

To further optimize its operational efficiency, in February 2024, Sprinter outsourced 20% of its production to factories in countries with lower operational costs. These factories cater exclusively to Sprinter's procurement demands but operate independently, with no direct involvement from Sprinter. Products from these suppliers are stored at Sprinter's distribution centers and dispatched for sales as needed.

The company's rapid production ramp-up, combined with Managing Director Mr. Aditya's strategic vision, and its successful penetration of international markets, led to significant profitability during the financial year 2023-24. This success reflects Sprinter's ability to swiftly scale operations, utilize cost-effective solutions, and establish a strong foothold in the global market.

Sprinter Private Limited's **mission** is to *become a globally recognized textile brand by delivering innovative, high-quality products, while maintaining integrity and placing sustainability at the forefront of its operations*. The company's **vision** is to *lead the global textile industry by setting new standards in quality, innovation, and ethical practices, ensuring sustainable growth and contributing positively to the community*. Sprinter's **long-term goals** include *achieving global market leadership by expanding into key international markets, sustaining 20% annual growth while maintaining operational excellence, investing in cutting-edge technology and research for continuous innovation, and ensuring ethical supply chain practices by maintaining transparency across operations*.

GST Compliance Challenges

During the fiscal year ended March 31, 2024, Sprinter achieved an impressive export turnover of ₹ 50 crores. The company opted to export with the payment of IGST and benefited from duty drawbacks, amounting to ₹ 2.00 crores, credited to its statement of profit and loss. By the end of the year, Sprinter's financial statements reflected a net profit before tax of ₹ 7.50 crores. Additionally, the company invested ₹ 10 lakhs in research and development, further strengthening its innovative edge in the market.

Despite its commercial success, the company's in-house GST team faced challenges in navigating GST liability on IGST payments and refunds, particularly concerning the export sales that began in Oct 2023. The made-ups valuing ₹5 crores were exported during Oct 2023, carrying

a GST rate of 5%. The break-up of ITC for month of Oct 2023 is as under:

Eligible ITC on inputs	0.15 crores
Eligible ITC on capital goods	0.03 crores
Eligible ITC in input services	0.02 crores

There were divergent opinions among team members pertaining to discharge of tax liability and refund issues given below before they could approach their tax consultant.

Opinion I - The overall IGST liability of the company pertaining to supplies in relation to export in Oct 2023 is ₹ 0.25 crores and it would be discharged by the company by availing ITC on inputs of ₹ 0.15 crores and balance of ₹ 0.10 crore would be discharged by company in cash. After discharge of liability and filing of periodical returns consisting of GSTR- 3B and GSTR-1, the above said amount of ₹ 0.25 crore would be refunded/refundable directly by customs in bank account of company.

Opinion II - The overall IGST liability of the company pertaining to supplies in relation to export in Oct 2023 is ₹ 0.25 crores and it would be discharged by the company by availing ITC on inputs of ₹ 0.15 crores, ITC on capital goods of ₹ 0.03 crore and ITC on services of ₹ 0.02 crores and balance of ₹ 0.05 crore would be discharged by company in cash. After discharge of liability and filing of periodical returns consisting of GSTR- 3B and GSTR-1, the above said amount of ₹ 0.25 crore would be refunded /refundable directly by customs in bank account of the company.

Opinion III - The overall IGST liability of the company pertaining to supplies in relation to export in Oct 23 is ₹ 0.25 crores and it would be discharged by the company by availing ITC on inputs of ₹ 0.15 crores, ITC on capital goods of ₹ 0.03 crore and ITC on services of ₹ 0.02 crores and balance of ₹ 0.05 crore would be discharged by company in cash. After discharge of liability and filing of periodical returns consisting of GSTR- 3B, GSTR-1, and GSTR-9, the above said amount of ₹ 0.25 crore would be refunded/refundable directly by customs in bank account of the company.

Opinion IV - The overall IGST liability of the company pertaining to supplies in relation to export in Oct 2023 is ₹ 0.25 crores and it would be discharged by the company by availing ITC on inputs of ₹ 0.15 crores, ITC on capital goods of ₹ 0.03 crores and ITC on services of ₹ 0.02 crores and balance of ₹ 0.05 crore would be discharged by company in cash.

After discharge of liability and filing of periodical returns consisting of GSTR- 3B and GSTR-1, the above said ITC amounting to ₹ 0.20 crore would be refunded/refundable directly by customs in bank account of the company.

The GST team's uncertainty highlighted the complexities of navigating export-related tax laws.

Capital Investments and Other Costs

The company imported machinery worth ₹ 8.65 crores from South Korea, with the cost being CIF at Mundra port. However, the company incurred ₹ 2.36 lakhs as clearing charges paid to DK Services Private Limited (including ₹ 0.36 lakhs on account of IGST) for availing services for getting consignments cleared from port.

Further, the company incurred ₹ 3.00 lakhs for freight services, paid to D Transport Services, a proprietary concern that is not registered under GST and owning 15 goods carriage. As a result, the company deposited ₹ 0.15 lakhs in IGST under the reverse charge mechanism.

Moreover, the company paid ₹1.77 crores to another company providing building construction services during the financial year 2023-24, which included ₹ 27 lakhs of IGST.

Rapid Growth and Strategic Leadership Under Mr. Aditya

Under the visionary leadership of Mr. Aditya, Sprinter Private Limited has rapidly established itself as a competitive force in the textile industry. The company's early success in penetrating the U.S. market, combined with its strategic investments in modern infrastructure, innovative marketing approaches, and capital expansion, has paved the way for sustained growth. Despite facing some challenges in GST compliance, Sprinter's strong performance and rapid export expansion reflect Mr. Aditya’s entrepreneurial acumen, strategic foresight, and unwavering determination to drive the company forward.

ANNEXURE

The Time

The New AgeSprinter Faces Scrutiny Over Child Labour and Unethical Practices in Overseas Supply Chain



Recent reports from several Third World countries have uncovered alarming instances of child labor within factories linked to global supply chains, including those associated with Sprinter, a leading global apparel brand. Despite child labor being illegal in these nations, it has been reported that factories outsource work to contractors who, in turn, illegally hire children, bypassing local law enforcement.

Although Sprinter itself has not directly engaged in these practices, acting only as a customer for these factories, its lack of initial intervention has drawn criticism. Working conditions in many of these factories are described as unhygienic and oppressive, with the exploitation of vulnerable workers being a widespread issue.

I. Multiple Choice Questions

10.1 Regarding tax liability of the said company for the month of Oct 2023 under provisions contained in GST laws and rules, which statement is correct?

(a) Opinion II is correct.

(b) Opinion III is correct.

(c) Opinion I is correct.

(d) Opinion IV is correct.

10.2 In context of the information given in under **"Capital Investments and Other Costs** of the case study, consider the following table of compliances under income tax law as well as under GST law:

Nature of Compliances	*Appropriate response of company in accordance with law*
(1) Deduction of TDS under income tax law and availing of eligible ITC under GST law	(i) TDS of ₹ 3,07,000/- is deducted on account of above three transactions and company is availing ITC of ₹ 51,000/- in respect of these transactions

(2) Deduction of TDS under income tax law and availing of eligible ITC under GST law	(ii) TDS of ₹ 2,30,250/- is deducted on account of above three transactions and company is availing ITC of ₹ 36,000/- in respect of these transactions
(3) Deduction of TDS under income tax law and availing of eligible ITC under GST law	(iii) TDS of ₹ 2,30,250/- is deducted on account of above three transactions and company is availing ITC of ₹ 27,51,000/- in respect of these transactions
(4) Deduction of TDS under income tax law and availing of eligible ITC under GST law	(iv) TDS of ₹ 3,07,000/- is deducted on account of above three transactions and company is availing ITC of ₹ 27,36,000/- in respect of these transactions

Which of the following forms appropriate response by the company in accordance with law?

(a) Combination (1) and (i)

(b) Combination (2) and (ii)

(c) Combination (3) and (iii)

(d) Combination (4) and (iv)

10.3 Given this scenario, in which stage of the product life cycle is Sprinter's made-up products most likely positioned?

(a) Shakeout

(b) Maturity

(c) Growth

(d) Introduction

10.4 Why should Sprinter address the issue of child labour in its supply chain? Select the **most appropriate** statements:

i. Sprinter is directly responsible for any faulty practices of its suppliers.

ii. Sprinter has a moral duty of care towards a broad range of stakeholders, even if they are not directly related to the company.

iii. Sprinter has a responsibility to ensure the well-being of employees working within its supply chain. The issue involves child labour exploitation by subcontractors.

iv. Sprinter has a responsibility to ensure the well-being of employees working within its factory only. The issue involves child labour exploitation by subcontractors.

v. Even though Sprinter hasn't done anything illegal, it has a moral obligation to protect the rights of these children. Child labour is prohibited in most countries because children have a right to education.

vi. Negative publicity regarding unethical production practices could damage Sprinter's business reputation.

Options

(a) ii, iii

(b) i, ii, iii, iv

(c) ii, iii, v, vi

(d) iii, iv, v, vi

10.5 Which of the following are the **most proactive steps** Sprinter can take to address the unethical practices in its supply chain?

i. Sprinter can develop a Code of Conduct that details the acceptable standards for conducting business.

ii. Sprinter can set up an audit team to regularly audit factories in both pre-sourcing and follow-up stages.

iii. Sprinter can list location-wise suppliers on its website, from whom it procures its products.

iv. The Board must take immediate action to address unethical practices in the supply chain by implementing strict measures to eliminate child labour and ensuring transparent communication of this commitment to all stakeholders.

v. Close production in countries with unethical practices.

vi. Play an active role in managing the business operations of its suppliers.

Options

(a) ii, iv

(b) i, ii, iii, iv

(c) i, iii, iv, vi

(d) i, ii, v, vi

II. Descriptive Questions

10.6 The promoters of the company are law compliant and do not want to be seen on the wrong side of law. However, they are also prudent minded and want to take tax benefits available legally and seek your advice.

Advise promoters of company of any such legally permissible benefits to lower its income tax liability for A.Y. 2024-25.

Ignore the adjustment on account of depreciation under the Income-tax Act, 1961.

10.7 The company has exported made ups of ₹ 50 crores on payment of IGST during year 2023-24 carrying a GST rate of 5%. Further, the company had availed ITC of ₹ 2.00 crore during year 2023-24. The details of same are as under:

Eligible ITC on inputs	₹ 1.50 crore
Eligible ITC on capital goods	₹ 0.36 crore
Eligible ITC on services	₹ 0.14 crore

DISCUSS whether there was any other legally permissible way to export its goods keeping in view provisions of GST law assuming that there are no domestic sales. Also make a cross comparison of export on payment of IGST vs. other legally compliant way in terms of financial burden/benefit and procedural requirements to the taxpayer company.

Make suitable assumptions.

ANSWERS TO THE CASE STUDY 10

I. Answers to the Multiple-Choice Questions

10.1 (a) Opinion II is correct.

Reason: The IGST liability of company pertaining to zero-rated supplies (export) in Oct 23 is 5% of ₹ 5crores i.e. ₹ 0.25 crore. It is discharged by setting off eligible ITC of ₹ 0.20 crore. It is immaterial whether ITC is availed on inputs, capital goods or input services. The export supplies are zero-rated supplies and IGST paid of ₹ 0.25 crore would be refunded/refundable directly in bank account of the company by customs upon monthly filing of GSTR-3B and GSTR-1 for each tax period. Further, filing of GSTR-9 is an annual affair and hence nothing to do with refund of IGST.

The refund by customs is system generated upon filing of GSTR-3B and GSTR-1 for each tax period. The invoices transmitted to customs via GST network are matched with shipping bills and others details which are also system driven and refund scroll is generated. After scroll generation, refund is credited in bank account of exporter.

10.2 (a) Combination (1) and (i).

Reason: The TDS amount to be deducted during financial year 2023-24 is as under -

TDS to be deducted on clearing charges of ₹ 2.00 lakhs u/s 194 C is 2% in case of payment to companies.

TDS to be deducted on freight paid of ₹ 3.00 lakhs u/s 194 C is 1% in case of payment to individuals.

TDS to be deducted on payment made to building contractor company of ₹ 1.50 crore u/s 194 C is 2% in case of payment to companies.

Hence, total TDS to be deducted by company comes to ₹ 3,07,000/- (4,000 + 3,000 + 3,00,000).

It is to be remembered that TDS is not to be deducted on GST amount included in payments made to above service contractors in accordance with provisions of CBDT circular number 23/2017 dated 19.7.2017. Hence, for calculation of TDS, pre-GST amounts have to be arrived at.

Further, company has correctly availed IGST on services amounting to ₹ 51,000/-. The company is eligible to avail ITC on services for import of machinery amounting to ₹ 36,000/-. Further, credit of IGST paid on reverse charge basis by the

company on freight services amounting to ₹ 15,000/- is also available to the company. The IGST on building contactor services is not eligible as amount would be capitalised under building and the same is blocked under section 17(5) of CGST Act.

10.3 (c) Growth

Reason: Given the scenario, Sprinter made-ups have received a very good response, and they have captured a significant share of export orders, indicating that the product is experiencing rapid market acceptance and sales growth.

10.4 (c) ii, iii, v, vi

Reason: Most appropriate statements are (ii) Sprinter has a responsibility to a *wide range of stakeholders*, including vulnerable children affected by its supply chain practices. (iii) Sprinter is accountable for ensuring the well-being of employees in its *supply chain*, especially regarding the exploitation of child labour by subcontractors. (v) Although Sprinter may not engage in illegal activities, it has a *moral obligation to protect children's rights*, as child labour is illegal in many countries and contradicts their right to education. (vi) Negative publicity surrounding unethical production practices can harm Sprinter's *brand reputation and customer trust*, which are critical for long-term success.

Statements (i) & (iv) are less appropriate.

(i) While Sprinter *may not be directly liable* for suppliers' actions, it is responsible for ensuring they adhere to ethical standards, highlighting the interconnectedness of its operations and supply chain. (iv) While the Sprinter does have a responsibility toward its factory employees, it must also extend this obligation to those working in its supply chain.

10.5 (b) i, ii, iii, iv

Reason: Sprinter can take several proactive steps to ensure ethical practices in its supply chain. These include developing a robust Code of Conduct (i), conducting regular audits to ensure compliance (ii), and publicly disclosing supplier information to enhance transparency (iii). Furthermore, the Board's commitment to eliminating child labour and communicating this effort (iv) strengthens the company's

ethical stance. Closing production in certain countries (v) and directly managing supplier operations (vi) are less feasible and may not effectively address the root issues. Instead, enforcing strict standards and conducting audits will ensure compliance while maintaining supplier independence.

II. Answers to the Descriptive Questions

10.6 In a major tax policy initiative, section 115BAB has been inserted w.e.f. A.Y. 2020-21 to provide an option to new manufacturing or electricity generating domestic companies set up and registered on or after 1.10.2019 and commences manufacturing or generating electricity on or before 31.3.2024 for availing concessional income tax rates subject to fulfilment of certain conditions contained thereunder like non-availability of profit-linked deductions and investment-linked tax deduction under the Act, non-availability of deduction for contribution to research and development, additional depreciation etc.

Section 115BAB provides for concessional rate of tax @15% (plus surcharge@10% plus HEC@4%).

The option for section 115BAB has to be exercised in the **very first year** in which the **eligible company is set up**, failing which it cannot exercise such option in the future years. However, once the company exercises such option under 115BAB, as the case may be, in a year, it would continue to be governed by the special provisions u/s 115BAB thereafter and cannot opt for regular provisions in any subsequent year.

It may be noted that companies exercising option under section 115BAB are not liable to minimum alternate tax under section 115JB.

The following are the conditions specified under section 115BAB:

(a) the company has been set-up and registered on or after the 1.10.2019, and has commenced manufacturing or production of an article or thing on or before the 31.3.2024 and, —

(i) the business is not formed by splitting up, or the reconstruction, of a business already in existence:

(ii) does not use any machinery or plant previously used for any purpose.

Any machinery or plant which was used outside India by any other person shall not be regarded as machinery or

plant previously used for any purpose, if the following conditions are fulfilled -

(A) such machinery or plant was not, at any time previous to the date of the installation used in India;

(B) such machinery or plant is imported into India from any country outside India; and

(C) no deduction on account of depreciation in respect of such machinery or plant has been allowed or is allowable under the provisions of this Act in computing the total income of any person for any period prior to the date of the installation of machinery or plant by the person.

Further, where in the case of a person, any machinery or plant or any part thereof previously used for any purpose is put to use by the company and the total value of the machinery or plant or part so transferred does not exceed 20% of the total value of the machinery or plant used by the company, then, the condition specified that the company does not use any machinery or plant previously used for any purpose would be deemed to have been complied with.

(b) the company is not engaged in any business other than the business of manufacture or production of any article or thing and research in relation to, or distribution of, such article or thing manufactured or produced by it.

The business of manufacture or production of any article or thing referred to in clause (b) shall not include business of,—

(i) development of computer software in any form or in any media;

(ii) mining;

(iii) conversion of marble blocks or similar items into slabs;

(iv) bottling of gas into cylinder;

(v) printing of books or production of cinematograph film; or

(vi) any other business as may be notified by the Central Government in this behalf; and

(c) the total income of the company has to be computed -

(i) without any deduction under the provisions of section 10AA or section 32(1)(iia) or section 33AB or section 33ABA or section 35(1)(ii)/(iia)/(iii) or section 35(2AA) or section 35(2AB) or section 35AD or section 35CCC or section 35CCD or under any provisions of Chapter VI-A other than the provisions of section 80JJAA or section 80M;

(ii) without set-off of any loss or allowance for unabsorbed depreciation deemed so under section 72A where such loss or depreciation is attributable to any of the deductions referred to in sub-clause (i).

(iii) by claiming the depreciation under the provision of section 32 determined in such manner as may be prescribed. However, additional depreciation u/s 32(1)(iia) cannot be claimed.

In the present case, company is eligible to opt for concessional tax rate of 15% (plus surcharge@ 10% plus HEC @ 4%), since it satisfies the following condition -

(1) It is a company registered after 1.10.2019 and has started production on or before 31.3.2024.

(2) Its business is not formed by splitting or reconstruction of business already in existence.

(3) Although it has used plant and machinery previously used, it falls within overall cap of 20% stipulated u/s 115BAB. The total value of plant and machinery used by the company is ₹ 10.65 crores. However, value of machinery previously used is only ₹ 2.00 crore which is 18.78% of total value of plant and machinery. Hence, this newly set up domestic company satisfies this criterion also.

(4) The company is engaged in business of manufacturing of an article or thing and research in relation to it.

(4) The company's business does not fall into prohibited categories.

(5) The company has not taken benefit of other beneficial provisions as listed out under section 115BAB.

(6) The company has to exercise the option by filing Form 10-ID by due date of filing first return of income under section 139 for A.Y. 2024-25.

10.7 As per section 16(3) of the IGST Act, 2017, a registered person making zero rated supply may supply goods and/or services under bond or Letter of Undertaking (LUT) without payment of IGST and claim refund of unutilized ITC. Further, notified class of persons may make zero-rated supply or notified class of goods or services may be exported, on payment of IGST and refund of such tax paid on goods and/or services supplied may be claimed. Accordingly, suppliers of textiles made-ups are permitted to export on payment of IGST and claim refund of such tax paid.

Rule 89(4) of the CGST Rules, 2017 stipulates that in the case of zero-rated supply of goods or services or both without payment of tax under bond/LUT in accordance with the provisions of section 16(3) of the IGST Act, 2017, refund of ITC shall be granted as per the following formula:

$$\text{Refund Amount} = \frac{\text{(Turnover of zero-rated supply of goods + Turnover of zero-rated supply of services)}}{\text{Adjusted Total Turnover}} \times \text{Net ITC}$$

Here, Net ITC means ITC availed on inputs and input services during the relevant period other than the ITC availed for which refund is claimed under sub-rules (4A) or (4B) or both. Thus, refund of ITC on capital goods is not allowed.

However, in case of export on payment of IGST, entire IGST paid would be refunded and ITC on input, input services and capital goods can be utilized for making payment of IGST. Refund under both the cases will be computed as follows:

Export under LUT or bond	
Tax liability	0
Refund of unutilized ITC	₹ 1.64 crore
Export on payment of IGST	
Tax liability	₹ 2.50 crore
Set off by using ITC	₹ 2.00 crore
Set off by payment of cash	₹ 0.50 crore
Refund of IGST paid	₹ 2.50 crore

In export under bond/LUT, ITC of input and input services amounting to ₹ 1.64 crore is refundable. In case of export on payment of IGST,

refund of IGST paid of ₹ 2.50 crore is available and IGST payable in cash is ₹ 0.50 crore.

In terms of procedural requirements, a separate refund application has to be filed electronically for exports under LUT. However, for exports on payment of IGST, refund is automatically granted by customs on valid filing of GSTR-3B and GSTR-1 and validation of tax invoice data with shipping bills and other information.

Further, in case of export under LUT, no tax is to be deposited by the company and refund of ITC has to be applied by way of separate application. Therefore, it does not involve any cash outflow at the time of export.

In case of export on payment of IGST, it involves cash outflow of ₹ 50.00 lakh which is refunded subsequently. Therefore, it involves temporary blockage of working capital for certain period of time. However, since refund process is system driven and automated as provided in rules under this route, it results in quicker refunds including refund of entire ITC and cash deposited.