FINAL COURSE

PAPER : 6
INTEGRATED BUSINESS SOLUTIONS

CASE STUDY DIGEST

BOARD OF STUDIES
THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

This Case Study Digest has been prepared by the faculty of the Board of Studies. The objective of this digest is to provide case studies for practice to the students to enable them to strengthen their preparation in the subject. In case students need any clarifications or have any suggestions to make for further improvement of the material contained herein, they may write to the Joint Director Board of Studies.

All care has been taken to provide interpretations and analysis in a manner useful for the students. However, the digest has not been specifically discussed by the Council of the Institute or any of its Committees and the views expressed herein may not be taken to necessarily represent the views of the Council or any of its Committees.

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Preface

Business decisions: both short-term and long-term: are based on strategic objectives. Effective decisions are those that have a positive impact on productivity & profitability and enhance the growth prospects of a business. Effective decision making requires the decision maker to consider a complete: holistic view of the business rather than having a siloed approach. Business does not work in silos: it is integrated and interconnected where decisions taken in one area can have a significant impact on other areas. Considering these principles: students are encouraged to integrate their professional values: practical work experience: and knowledge gained from specific academic studies. The goal is to cultivate a skillset capable of crafting well-organized: integrated business solutions.

Integral to the Integrated Business Solutions (IBS) curriculum is the 'Case Study': a vital aspect of the CA Final Level. Here: students must apply their knowledge gathered from the five core subjects at final level and Self-paced Modules Set A & B. Each 'Case Study' unfolds a unique business situation: presenting a scenario complete with mission: vision: objectives: challenges: key stakeholders: and relevant data. Strategic decision-making involves a meticulous analysis of the business model and subsequent strategic adaptations. Decisions may range from new product development and market exploration to considering diversification: whether in related or unrelated areas. The choice between related and unrelated areas presents challenges: as stakeholders may resist the later due to perceived risks: potentially impacting market capitalization. In the case of a strategic shift towards a related area: exploration of options such as horizontal integration or vertical integration (whether forward or backward integration) in the supply chain is crucial.

These strategic moves require a lot of financial decisions. In addition to that there is a need for a robust financial risk management system. Moreover: proper adherence to accounting standards: tax laws and other statutory compliances under the various corporate legislations are fundamental to the strategic decision. Adhering to these standards ensures legal compliance: shielding the company from legal repercussions and fines. Well imbibed multifaceted decision also ensures accurate measurement and presentation of financial results. This: in turn: aids management in allocating resources efficiently and evaluating the performance of various business units or projects based on reliable financial data.

On top of that: good corporate governance: fostering ethical business practices: influences an organization's strategy and performance. This emphasis on ethics is essential not only for business organisations but also for CAs: as stakeholders place enormous confidence in their role. The increasing instances of corporate frauds and subsequent failures: with ripple effects on economies: have increased the responsibilities of CAs to ensure that organizations discharge their reporting responsibilities diligently.

Hence: the integrated approach advocated in Core Paper-6 at the CA Final Level emphasizes the importance of considering interrelated issues spanning finance: accounting standards: assurance: taxation: company law: and other compliances alongside strategic decision making.

The Case Study Digest includes 50 case studies: many of which focus on contemporary business models used by reputable companies across various sectors. These sectors include the beverage industry (specifically the tea segment): e-commerce: transportation: telecommunications: the aviation sector: food and hospitality: the construction industry: healthcare: and the fast fashion industry. Each case study provides an in-depth analysis of the innovative strategies and practices driving success in these fields.

To effectively tackle the questions posed in these case studies: it is essential to integrate and apply the provisions: concepts: and principles acquired through study materials: along with staying updated with statutory and judicial updates. Prior to solving the case studies: thorough comprehension of aforesaid subjects is necessary. Subsequently: these concepts and provisions should be applied when reading the case studies in this digest. This involves evaluating the issues presented: synthesizing information: and performing the necessary computations as required by the questions. This process not only aids in addressing the questions accurately but also enhances the ability to recommend solutions and advise on higher-level analytical and interpretational matters.

To effectively engage with this subject: envision the role of a Senior Manager: Finance Director: Auditor: or CEO. The task demands an intimate understanding of the organisation: its intricacies: and its operations. Responsibilities encompass crafting and implementing strategic and financial plans: as well as overseeing the adherence to statutory compliances. By engaging in this methodical approach—reading: identifying issues: and solving questions—the capability to approach the examination with confidence and a positive attitude will be cultivated.

Wishing you happy reading!

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CASE STUDY 1

Caber Cabs, which is better known by the name Caber, is an Indian startup company (privately held) which provides online cab services to the greater population of the country. It was founded in the year 2008 by Ikshit Bothra (current CTO) and Saurabh Jain (current CEO). Caber initiated its operations and services from Chennai and now the headquarters of this startup company is based in Pune. Within a span of few years, Caber Cabs have expanded its base to as many as 85 cities across the country with around 2 lakh cars operational in its online cab services. In 2012, the startup company also went forward to provide auto-rickshaw services to the middle-class clan of the Indian families through its mobile app in few selected cities like Mumbai, Hyderabad, Jaipur and so more.

In FY 2022, Caber's market share accounted for approximately 55%, and it reached a valuation of 6.5 billion US dollars in 2023. Caber's business model disrupted the traditional taxi industry by offering a more convenient and efficient way to hail rides. The company utilized a technology-driven approach, using algorithms to match riders with nearby drivers and optimize routes, dynamic pricing model, known as "surge pricing," adjusted fares based on demand, allowing the company to maximize revenue during peak hours. It faced regulatory challenges and opposition from taxi unions in many cities, leading to legal battles and protests.

Major customer segments of Caber are individuals who do not own a car or can't drive on their own. A segment of people who need an affordable ride – they share cab services by pooling a group of people from a common area. Various customers who need a premium ride or a quick ride also book rides with Caber. Overall, it serves the people who are looking for convenient cab bookings. Caber Cabs is amongst the fastest growing online cab service providers in India and aims to dominate the Indian market with its innovative and customer-oriented business strategy which includes - Mobile App awareness to the common people through the launch of a customized mobile-specific technique named as "App Analytics" with the help of which the app can track and measure the overall performance of the services in particular city or through the drivers. Providing Ad campaigns on various social media platforms. Targeting the right audience which as per a recent study has confirmed that the average customers were of 20-25 years of age who were working in the corporate companies and needed cab services to pick them up and drop them at their office premises

Caber works as a digital aggregator app platform, connecting passengers who need a ride from point A to point B with drivers that are willing to serve them. "**Passengers**"

generate the demand, "**Drivers**" supply the demand and "**Caber**" acts as the marketplace/facilitator to make this all happen seamlessly on a mobile platform. Caber has been able to generate strong value propositions for both passengers and drivers to get onboard on its platform and create disruption in the taxi/ cab industry.

Certain facilities provided by Caber to its passenger customers are convenient cab bookings. Real-time tracking, the ride hailing service refers to the ability of passengers to track the location of their assigned vehicle in real time using the mobile app. This feature provides passengers with an estimated time of arrival and allows them to see the route the driver is taking to reach their location. It promotes cashless rides by giving the option for passengers to pay for their rights using digital payment methods such as debit cards, mobile wallets or Caber Money (Caber's digital wallet). This eliminates the need for passengers to pay in cash at the end of their ride, offering a convenient and secure payment experience. Further, the passengers using the Caber app experience shorter waiting times. This could be due to factors such as the availability of nearby drivers, efficient routing and effective matching logarithms that quickly connect passengers with available drivers. Lower wait times contribute to a better overall experience for passengers, reducing the time they spend waiting for their ride to arrive. Its app provides an upfront pricing feature, it shows the estimated fare for the trip before confirming the booking. This estimated fare is calculated based on factors such as distance, time, and any surge pricing that may be applicable at the time of booking. By providing upfront pricing, Caber aims to offer transparency to passengers regarding the cost of their ride, helping them make informed decisions before booking a ride. In the Caber app, "multiple ride options" typically refers to the various categories or types of rides available for users to choose from when booking a ride. These options may include Caber micro offers small and affordable cars for short trips or solo travelers. These multiple ride options cater to the diverse needs and preferences of Caber users, providing flexibility in terms of vehicle type, comfort level, and pricing. Users can select the option that best suits their requirements for each specific journey.

The hiring department at Caber undertakes an extensive search to hire experienced drivers, who can be further trained to professionally handle high-end luxury segment customers. For this, the company plans to approach a staffing agency that will provide candidates based on Caber's specific requirements for an experienced driver. They will also do the background check for these drivers to ensure their fitness and safety record. Caber plans to have regular maintenance done on the cars to ensure that they are in working condition. They also have approached insurance companies for car and accident insurance.

After hiring its Drivers, they provide flexibility to drive on their own terms like setting their own schedule based on their preferences – day shift, night shift, full time or part time. Drivers can also decide where they want to opera1 within the service area. They may prefer to work in specific neighborhoods, cities, or regions based on factors such as demand, traffic conditions, or familiarity with the area. Caber training sessions for drivers are comprehensive and focused on enhancing professionalism, safety, and customer satisfaction. Covering a range of topics including safety protocols, customer service skills, navigation techniques, vehicle maintenance, company policies, technology usage, and financial management, these sessions aim to equip drivers with the necessary knowledge and skills to excel in their role. By providing education and guidance in these key areas, Caber ensures that its drivers can deliver a reliable, safe, and enjoyable experience for passengers while also empowering them to manage their work effectively as independent contractors in the ride-hailing industry.

Caber supports its drivers by facilitating access to vehicle loans, enabling them to become vehicle owners and enhance their earning potential. Through partnerships with financial institutions, Caber offers specialized loan programs with competitive interest rates and flexible repayment terms tailored to the needs of ride-hailing drivers. Additionally, Caber runs a vehicle leasing program in many cities to help new drivers get onboard faster. Drivers pay an upfront security deposit for the vehicle, and payments are automatically deducted on a weekly basis from their earnings. Caber purchases motor vehicles or motor cars from Shakti Motors and leases out to its drivers. The lease agreement states that in case of default by drivers for payment of lease rent or other terms and conditions, Caber has power to repossess the motor cars/vehicles leased out. The registration of vehicles is in the name of lessee as per the provisions of Motor Vehicles Act, 1988. Caber has claimed a depreciation of ₹ 5.00 crores during the previous year 2023-24 on the motor cars leased out

Caber makes money by taking a cut on each ride (shared or individual) from the drivers. Caber provides the drivers on its platform with a robust supply of ride requests to accept, fulfill, and make income. While making a booking, the passenger pays Caber for the ride through the app. Caber then transfers the payment to the driver's account after taking some amount of trip commission for doing the job of a broker. The commission rates may vary from 15-30 % depending on the market.

Dynamic pricing/ surge pricing is charged whenever there is a higher demand for cabs than what can be served at that moment (for example, at the airport after a flight lands), the fare goes up based on a surge price calculation algorithm. If a passenger cancels a ride after a certain time frame, say five minutes, he/she is charged a cancellation fee.

Caber App is a very popular app with millions of active users. This makes it a good option for brands to do promotions. Its current app interface pushes a feed style layout for intuitive content consumption. Over the period, it may go on to become a strong revenue source by becoming a channel for sponsored content.

The company offer discounts and promotions to end-users (that are not our customers) to encourage use of the platform. These are offered in various forms of discounts and promotions and include:

- Targeted end-user discounts and promotions: These discounts and promotions are offered to a limited number of end-users in a market to acquire, re-engage, or generally increase end-users use of the Platform, and are akin to a coupon.
- End-user referrals: These referrals are earned when an existing end-user (the referring end-user) refers to a new end-user (the referred end-user) to the platform and the new end-user who is not our customer takes their first ride on the platform. These referrals are typically paid in the form of a credit given to the referring end-user. These referrals are offered to attract new end-users to the Platform. The company records the liability for these referrals and corresponding expenses as sales and marketing expenses at the time the referral is earned by the referring end-user.
- Market-wide promotions: These promotions are pricing actions in the form of discounts that reduce the end-user fare charged by Drivers to end-users. This also includes any discounts offered under our subscription offerings and certain discounts within the Caber Rewards programs, which enable End-users to receive a fixed fare or a discount on all eligible rides. Accordingly, Caber records the cost of these promotions as a reduction of revenue at the time the transaction is completed.
- Refunds and credits to end-users due to end-user dissatisfaction with the Platform are recorded as marketing expenses or as a reduction of revenue.

Caber offers 24x7 customer support to ensure that passengers and drivers receive assistance at any time, enhancing the overall user experience. Caber's value proposition revolves around providing convenient, safe, and reliable transportation solutions for passengers while offering flexible earning opportunities and support for its driver-partners.

Recently Caber is planning to introduced customized luxury rides to attract high end customers in all metropolitan cities in India best known for their fast-paced lifestyle. Due to expansion of business in various segments requiring restructuring in leadership team for effective management the board has decided to increase the number of directors. Caber wishes to diversify its current business in various segments to enhance its portfolio. As per the Board, new hands are required for decision-making for which qualified and experienced personnel are

required to be appointed as directors. Currently, the company already has 7 directors. Now with the revised strategy, the Board of Directors desires to increase the number of directors from 7 to 16.

In FY 2022, Caber's market share accounted for approximately 55%. It has reached a valuation of 6.5 billion US dollars in the year 2023.

Sample Fare Break-up: X books an auto for travelling from Jhotwara, Jaipur to Sanganer, Jaipur. Y an auto driver, a resident of Rajasthan accepted the ride. On completion of trip the operator received fare from X, a probable break-up of it can be as under:

Driver Fees – ₹ 800

Booking and convenience Charge – ₹ 200

I. Multiple Choice Questions

1. Which of the following statements accurately describe characteristics of disruptive innovations of Caber?

   i. Caber initially targeted niche markets to establish its presence

   ii. Caber offered competitive performance and quality compared to existing products or services

   iii. Caber immediately dominated the market upon introduction

   iv. Established companies did not align with the preferences of their current customers and overlooked Caber's disruptive innovations

   v. Caber's innovations tend to evolve and improve over time, eventually surpassing existing products or services

   (a) a, b, and d only

   (b) a, c, and e only

   (c) b, d, and e only

   (d) a, c, and d only

2. With reference to fare break-up, what should be the total amount of fare and GST assuming the rate of GST as 5%, if X hailing the ride is not claiming ITC on above and also who is the person liable to pay GST in the given case?

   (a) ₹ 1,050, CGST ₹ 25, SGST ₹ 25; Caber cabs

   (b) ₹ 1,010, CGST ₹ 5, SGST ₹ 5; X

(c) ₹ 1,120, CGST ₹ 60, SGST ₹ 60; Y

(d) ₹ 1,096, CGST ₹ 48, SGST ₹ 48; X

3. Caber charging a premium for instant booking of prime cars had provided a new value to customers by making service access easier and more convenient than its basic version. Adaptability to which model created a significant advantage for the organization.

(a) Experience Model

(b) Subscription Model

(c) On Demand Model

(d) Free Model

4. Analysing the facts from the above, determine which classification best describes Caber's current growth stage?

(a) Startup

(b) Scale-up

(c) Unicorn

(d) Incumbent

5. Which statement is correct regarding the increase in the number of directors in accordance with the provisions of the Companies Act, 2013?

(a) The increase in the number of directors can be implemented by passing a general resolution in the general meeting.

(b) The company should pass a special resolution in the general meeting to increase the maximum number of directors to 16.

(c) The company cannot increase the number of directors beyond 10.

(d) The company cannot increase the number of directors beyond 15.

II. Descriptive Questions

6. Based on the scenario, how did Caber address customer pains and generate gains, and what specific strategies and features did it implement to enhance the overall customer experience and contribute to social and environmental benefits? DISCUSS.

7. DRAW a business model canvas for Caber.

8. With reference to Case, the depreciation claim is rejected by the Assessing Officer on the ground that the Caber had only financed for purchase of leased vehicles and hence it is neither owner nor used the same motor cars in his business. Comment on the contention of the Assessing Officer.

ANSWERS TO THE CASE STUDY 1

I. Answers to the Multiple Choice Questions

1. (i) a, b, and d only

Reason:

a. Caber initially targeted niche markets to establish its presence: This statement accurately reflects Caber's strategy of targeting specific cities or areas where traditional taxi services were inadequate. By focusing on niche markets initially, Caber established its presence and gradually expanded its operations.

b. Caber offered competitive performance and quality compared to existing products or services: Caber aimed to provide a competitive alternative to traditional taxi services by offering features such as surge pricing, real-time tracking, and cashless payments. This allowed Caber to meet or exceed the performance and quality expectations of customers.

d. Established companies did not align with the preferences of their current customers and overlooked Caber's disruptive innovations: Traditional taxi companies overlooked Caber's disruptive innovations, such as surge pricing and dynamic pricing algorithms. They didn't align with the preferences of their existing customer base. This oversight gave Caber an advantage in capturing market share and disrupting the industry.

2. (a) ₹ 1,050, CGST ₹ 25, SGST ₹ 25; Caber cabs

Reason: Section 9 (5) of the CGST Act 2017 is a charging section under GST for supply of notified services. This section deals with taxability of supply of services, the output tax of which shall be paid by the electronic commerce operator (E-COM) if such services are supplied through it, (even though E-COM is not an actual supplier).

Here, Notified services includes Services by way of Transportation of passengers by a Radio Taxi, Motor Cab, Maxi Cab, Motor Cycle or any other motor vehicle except omnibus therefore provisions of Section 9(5) of CGST is applicable on Caber Cabs. Therefore, the person liable to pay GST is Caber Cabs.

To find the fare and GST amount if X hailing the ride is not claiming Input Tax Credit (ITC), we'll calculate as follows:

Driver Fees = ₹ 800

- Booking and Convenience Charge = ₹ 200

GST rate is CGST 2.5% and 2.5% SGST

Step 1: Calculate the taxable value.

Taxable value = Driver Fees + Booking and Convenience Charge

Taxable value = 800 + 200

Taxable value = ₹1,000

Step 2: Calculate the GST amount.

GST amount = Taxable value x GST rate

CGST = ₹ 25 (1,000 x 2.5/100)

SGST = ₹ 25 (1,000 x 2.5/100)

Step 3: Calculate the total fare.

Total fare = Taxable value + GST amount

Total fare = ₹1,000 + ₹25 +₹ 25

Total fare = ₹1,050

- The fare charged to the passenger is ₹ 1,050, which includes the driver fees and booking/convenience charge.
- The GST amount on this fare, when not claiming ITC, is ₹ 50, calculated at a rate of 5% on the taxable value of ₹ 1,000.

3. (c) On Demand Model.

Reason: Caber's strategy of charging a premium for instant booking of prime cars aligns with the On Demand Model. This model focuses on providing immediate access to products or services, often at a premium price, to meet the immediate needs and demands of customers. By offering instant booking of prime cars, Caber enhances its value proposition by providing convenience and accessibility to customers, thereby creating a significant advantage for the organization within the On Demand Model.

4. (c) Unicorn

Reason: Caber is a privately held company with a valuation of $6.5 billion, which meets the criteria for being classified as a unicorn. While it has already established its presence in the market, expanded its operations, and diversified its services, its valuation of $6.5 billion indicates that it has achieved significant growth and is valued at over $1 billion, thus meeting the criteria for being classified as a unicorn. Therefore, "unicorn" would be the most appropriate classification for Caber's current growth stage.

5. **(b)** The company should pass a special resolution in the general meeting to increase the maximum number of directors to 16.

Reason: According to Section 149(1) of the Companies Act, 2013, the maximum number of directors allowed without a special resolution is 15. However, any increase beyond this limit requires the company to pass a special resolution as per the First Proviso to Section 149(1). Therefore, option B is correct as it accurately reflects the legal requirement for increasing the number of directors beyond the statutory limit.

II. Answers to the Descriptive Questions

6. **Pain & Pain Relivers**: Pains describe anything that annoys the customer before, during, or after getting a job done, including unwanted costs, situations, negative emotions, or risks. These pains can vary in severity. Pain relievers explain how products and services alleviate specific customer pains at different stages. They highlight how the value proposition addresses these pains by either eliminating or reducing them.

In the given study, customers often experienced difficulty finding a taxi during peak hours or in less busy areas. Caber relieved this pain by eliminating the hassle of waiting on the street or making phone calls to book a cab, offering a convenient and seamless booking experience. With efficient routing algorithms and effective matching mechanisms, Caber significantly reduced waiting times for passengers, ensuring a quicker and more reliable ride. Another major pain point for customers was concerns over the safety and security of rides, especially during late hours. Caber alleviates this by maintaining stringent safety protocols and conducting thorough background checks on drivers, ensuring passengers feel confident and secure when using Caber's services. Traditional taxi services often involved haggling and unpredictable pricing, which Caber relieved with upfront pricing, allowing passengers to see the estimated fare before confirming the booking, thus eliminating surprises at the end of the ride . Additionally, the inconvenience of cash payments and the need for exact change was eliminated with Caber's cashless payment options, offering a secure and hassle-free payment experience. Passengers can pay for their rides using digital payment methods such as debit cards, mobile wallets, or Caber Money (Caber’s digital wallet).

Gain & Gain Creators: Gains describe the outcomes or benefits that customers require, expect, or desire, including unexpected but delightful complementary benefits. These can range from functional utilities and social gains to positive emotions and cost savings. Some benefits will be more relevant to customers than others, and these elements collectively describe the customer characteristics observable in the market. Gain creators explain how a business's products and services generate customer gains by creating these benefits and outcomes.

Caber *catered to customer preferences* by providing multiple ride options, including economy, premium, and shared rides, allowing customers to choose based on their needs and budget. *Customers expected* consistent and high-quality service, which *Caber delivered* through features like in-app navigation, trip sharing, and 24x7 customer support, enhancing the overall ride experience.

Caber's user-friendly app interface *simplified the process* of booking a ride, offering functional utility by allowing users to book rides quickly with just a few taps, providing real-time tracking, driver contact information, and estimated arrival times. Complementary benefits like Caber Rewards and other loyalty programs offered ride discounts, priority support, and other perks to frequent users, adding value and encouraging repeat usage. Caber's competitive pricing and diverse ride options made it an *affordable and accessible transportation solution* for passengers of all budgets.

Additionally, Caber *offered* flexible earning opportunities for its driver-partners, allowing them to set their own schedules, choose their preferred working locations, and accept or decline ride requests as per their preferences. This created gains by providing employment opportunities for drivers and facilitating economic transactions, thereby contributing to the growth and development of local communities. These social gains were complemented by Caber's environmental contributions. Caber's ride-sharing options and efficient routing algorithms helped in reducing traffic congestion and carbon emissions, promoting environmental sustainability.

7.

Key Partners 	**Key Activities** 	**Value Proposition** 	**Customer Relationship** 	**Customer Segments** 
▪ Technology providers ▪ Financial Institutions ▪ Insurance ▪ MAP API providers ▪ Payment processors ▪ Local	▪ Communication with the driver, customers, and partners ▪ Hiring drivers and handling their insurance and payouts through secure medium ▪ Analyzing data	▪ Flexible earning opportunities for its driver-partners ▪ Safety and security ▪ Convenient and easier transactions	▪ Review & rating ▪ Social media engagement ▪ Customer Support 24x7	▪ Passengers ▪ Drivers ▪ Retailers

<table>
<tr>
<td rowspan="2">authorities
▪ Drivers who own cars
▪ Staffing agency</td>
<td>to rectify any shortcomings
▪ Sales promotions to acquire new customers
▪ Platform development</td>
<td rowspan="2">▪ Opportunity to get an insight as to the fare and duration of the ride
▪ Competitive pricing and diverse ride options
▪ Complementary benefits</td>
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<tr>
<td>Key Resources
▪ Platform
▪ Pricing algorithm
▪ Brand
▪ Staff</td>
<td>Channels
▪ Caber App</td>
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₹</td>
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₹</td>
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▪ Insurance cost
▪ Platform development & maintenance
▪ Customer support
▪ Salaries
▪ Sales & marketing cost
▪ Data center and networking expenses
▪ R & D expenses</td>
<td colspan="3">▪ Ride transaction fees
▪ Dynamic/ Surge pricing
▪ Cancellation fees
▪ Caber App interface</td>
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8. **Issue:** The issue under consideration is whether depreciation on leased vehicles can be denied to the lessor on the ground that the vehicles are registered in the name of the lessee and that the lessor is not the actual user of the vehicles.

Provision involved: Section 32 provides the manner of calculation of depreciation and conditions to be fulfilled as follows:

- The assets must be owned, wholly or partly, by the assessee.
- The assets must be in use for the business or profession of the taxpayer. If the assets are not used exclusively for the business, but for other purposes as well, depreciation allowable would be proportionate to the use of business purpose.

The Income Tax Officer also has the right to determine the proportionate part of the depreciation under section 38 of the Act.

- Co-owners can claim depreciation to the extent of the value of the assets owned by each co-owner.
- Assessee cannot claim depreciation on the cost of land.

Analysis: Section 32 imposes a twin requirement of "ownership" and "usage for business" as conditions for claim of depreciation thereunder. As far as usage of the asset is concerned, the section requires that the asset must be used in the course of business. It does not mandate actual usage by the assessee itself. **In this case, the assessee did use the vehicles in the course of its leasing business. Hence, this requirement of section 32 has been fulfilled, notwithstanding the fact that the assessee was not the actual user of the vehicles.**

As long as the assessee-lessor has a right to retain the legal title against the rest of the world, he would be the owner of the asset in the eyes of law. In this regard, the following provisions of the lease agreement are noteworthy –

- The assessee is the exclusive owner of the vehicle at all points of time;
- The assessee is empowered to repossess the vehicle, in case the lessee committed a default;
- At the end of the lease period, the lessee was obliged to return the vehicle to the assessee;
- The assessee had a right of inspection of the vehicle at all times.

The proof of ownership lies in the lease agreement itself, which clearly points in favour of the assessee.

Conclusion: The assessee-lessor was, therefore, entitled to claim depreciation in respect of vehicles leased out since it has satisfied both the requirements of section 32, namely, ownership of the vehicles and its usage in the course of business. Hence the contention of Assessing Officer in rejecting the depreciation claim is not valid.

Note - The facts given in the question are similar to the facts in I.C.D.S Ltd. Vs. CIT [2013] 350 ITR 527, wherein the above issue came up before the Supreme Court. The above answer is based on the rationale of the Supreme Court.

CASE STUDY 2

SG's adherence to its strategic vision is pivotal in maintaining its competitive advantage in the fast fashion industry. Concerns about the quality of products from fast-fashion companies are common, as these companies often aim to sell more by cutting costs. However, SG's robust quality control system ensures the delivery of high-quality products, distinguishing it from many of its competitors.

One of SG's key strategies to sustain its competitive edge is minimizing the time span between design creation and store availability. The fast fashion industry is accelerating, with companies continuously reducing the time from product design to distribution. The integration of online platforms and the normalization of one-day delivery are becoming industry standards. SG is committed to keeping pace with these developments to stay competitive.

Marketing and communication also play crucial roles. Leveraging information technology, SG can identify customer preferences and reach a broad audience. Social media is a significant tool in building relationships with customers, and SG utilizes these platforms effectively. It also utilizes it for super-efficient analysis of what's selling and being said on social media platforms. However, in a highly competitive industry, SG must constantly innovate, focusing on quality, pricing, and speed to retain its market position.

SG operates globally, with a substantial presence in Belgium and a significant influence in the fast fashion market. Competing with brands like RopTop, Rametton, R&M. SG produces over 20,000 designs annually and employs a strategic pricing strategy to carve out its market niche.

Pricing is critical for SG, which targets a wide market by offering products for women, men, and children. SG's pricing strategy aims to attract both the middle class, its largest market share, and wealthier individuals. In the South Asian market, SG's products are relatively affordable, catering primarily to the middle class. Conversely, in regions like Europe, SG's products are more expensive, targeting consumers with higher social status. In South Asian market, SG employs a below-market or penetrating pricing strategy, often referred to as a charming price tactic, which involves setting prices lower than the competition to attract a larger customer base, particularly among the middle class. This approach helps SG capture a significant market share by appealing to price-sensitive consumers. In contrast, SG adopts a different approach in the European market by setting prices higher than those in other regions. This strategy targets consumers who are less sensitive to price and are willing to pay a premium for SG's fashionable

and trendy products. By catering to a wealthier segment that values brand prestige and exclusivity, SG effectively maximizes its profits in Europe.

SG's pricing strategy is part of its broader 4Ps marketing mix: product, price, promotion, and place. With a diverse product range, SG attracts a broad consumer base, launching new products regularly to meet changing fashion demands. This approach maximizes profit margins by aligning product prices with consumer behavior and preferences.

SG has used almost zero advertising and endorsement policy throughout its entire existence, preferring to invest a percentage of its revenues in opening new stores instead. It spends a meager 0.8 per cent of sales on advertising compared to an average of 5 per cent by competitors. The brand's founder Mr. Goyal who is the ninth richest man in the world, has never spoken to the media nor has in any way advertised SG.

It currently operates in 1113 retail stores across 93 markets (countries). The flagship locations are located in the most critical markets that appeal to their most loyal shopper. SG uses its store location and store displays as key elements of its marketing strategy. Its window displays, which showcase the most outstanding pieces in the collection, are also a powerful communication tool designed by a specialized team. A lot of time and effort is spent designing the window displays to be artistic and attention grabbing. According to SG's philosophy of fast fashion, the window displays are constantly changed. This strategy goes down to how the employees dress as well – all SG employees are required to wear SG clothes while working in the stores, but these "uniforms" vary across different SG stores to reflect socio-economic differences in the regions they were located.

SG's pricing strategy and broad product range have given it an advantage over rivals like R&M and RopTop, enabling global expansion to meet product demand. A company's pricing strategy significantly impacts market presence and revenue returns. SG's strategy aims to meet consumer needs and outperform competitors to maximize returns.

SG, part of the Goyal group, has gained global recognition through its innovative retail strategy. Unlike many competitors, SG minimizes the time between design conception and store availability to just two weeks, allowing it to respond swiftly to market demand fluctuations. This agility is enhanced by SG's vertical integration and avoidance of outsourcing, maintaining control over production and quality.

SG's business model is meticulously designed to maintain its competitive edge in the fast fashion industry. A key element is the short lead time, which ensures that SG's products are always aligned with the latest fashion trends. This is complemented by the strategy of reduced

risks through limited production runs, allowing SG to quickly pivot away from unpopular designs. The company focuses on producing styles rather than mass-producing clothing, which helps keep its offerings fresh and desirable. Vertical integration, with manufacturing based in Asia, allows for rapid adjustments in production to meet market demands.

SG's marketing strategy is innovative, investing in making its products easily accessible rather than relying on traditional advertising methods. The company is highly reactive, swiftly responding to market demands as they arise, and it emphasizes affordability, offering stylish clothing at reasonable prices. Interactivity is another crucial aspect, as SG closely engages with consumer trends through social media, ensuring that it stays in tune with customer preferences. This combination of elements creates a dynamic and responsive business model that drives SG's success.

Aware of SG's recent successes in becoming a major player in the global fashion industry, many smartphone and mobile software manufacturers quickly sought to partner with the company. For instance, since 2012, Ramson smartphones have been sold with the preinstalled SG mobile application. Ramson Electronics announced the launch of the SG fashion app, which will showcase the global fashion chain's latest collections on Android smartphones for the first time. The app allows fashion lovers to browse the new season must-haves and make immediate purchases. This initiative has significantly contributed to SG's substantial sales growth. With the SG mobile application installed on their smartphones, customers can conveniently purchase the company's products online without needing a computer.

SG's success stems from a combination of innovative manufacturing and marketing strategies, allowing it to remain competitive. However, maintaining this edge requires continuous adaptation and technological advancement in marketing activities.

Particulars of SG India (Indian Subsidiary)

Employee Details and Profit Distribution- SG India has a headcount of around 1,000 employees in 2023- 2024. As per the company's policy, the employees are given 35 days of privilege leaves (PL), 15 days of sick leaves (SL) and 10 days of casual leaves (CL). Out of the total PL and sick leaves, 10 PL leaves and 5 sick leaves can be carried forward to next year. Based on past trends, it has been noted that 200 employees will take 5 days of PL and 2 days of SL and 800 employees will avail 10 days of PL and 5 days of SL. Indian Subsidiary has been incurring profits since 2018. Therefore, it has decided in 2023-2024 to distribute profits to its employees @4% during the year. But, due to the employee turnover, the expected pay-out of the Indian Subsidiary is expected to be around 3.5%. The profits earned during 2023-2024 is ₹ 2,000 crores. It has a post-employment benefit plan also available which is in the nature of

defined contribution plan where contribution to the fund amounts to ₹ 100 crores which will fall due within 12 months from the end of accounting period. Indian Subsidiary has paid ₹ 20 crores to its employees in 2023-2024.

Corporate Social Responsibility- The management committee of SG India Ltd has issued right shares to all its shareholders which include employees of the company. Furthermore, SG India issues its own shares to a charity without any consideration to an NGO which is working for promoting gender equality, empowering women, setting up homes and hostels for women and orphans; setting up old age homes, day care centres and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward group.

Asset Acquisition - On 1st April 2023, SG India acquired machines for production at Gwalior plant under the following terms:

List price of machines	₹ 80,00,000
Import duty	₹ 5,00,000
Delivery fees	₹ 1,00,000
Electrical installation costs	₹ 10,00,000
Pre-production testing	₹ 5,00,000
Purchase of a five-year maintenance contract with vendor	₹ 7,00,000

In addition to the above information, it was granted a trade discount of 10% on the initial list price of the asset and a settlement discount of 5%, if payment for the machine was received within one month of purchase. The company paid for the plant on 20th April, 2023. The machines were operating below capacity for 4 months. During this period, production cost of ₹ 2,00,000 per month was being incurred. The proceeds from sales was ₹ 1,50,000 per month. Similarly, the proceeds of sales from pre-production testing was ₹ 1,00,000.

Real Estate Transaction- SG India holds a commercial plot in Mumbai which it intends to sell. M/s. Best Broker, a real estate broker with its Head Office in the USA, has been appointed by SG India to find some suitable buyers for the said commercial plot in Chennai which is situated at a prime location. M/s. Best Broker identifies Legacy Estate Inc., based out of USA, as the potential buyer. It is to be noted that Legacy Estate Inc. is controlled from India and hence, is a 'Person Resident in India' under the applicable provisions of Foreign Exchange Management Act, 1999. A deal is finalised and Legacy Estate Inc. agrees to purchase the commercial plot for USD 7,00,000 (assuming 1 USD = ₹ 84). According to the agreement, SG India is required to pay commission @ 7% of the sale proceeds to M/s. Best Broker for arranging the sale of

commercial plot to Legacy Estate Inc. and commission is to be remitted in USD to the Head Office of M/s. Best Broker located in USA.

I. Multiple Choice Questions

1. Which of the following best describes how SG's type of vertical integration contributes to its competitive advantage in the fast fashion industry?

   (a) Backward vertical integration, by acquiring raw material suppliers, leading to cost savings through economies of scale.

   (b) Forward vertical integration, by opening own retail stores, enhancing customer experience and control over sales channels.

   (c) Backward vertical integration, by maintaining in-house production and control over the entire supply chain, allowing for rapid adjustments in production to meet market demands.

   (d) Forward vertical integration, by developing unique marketing strategies, increasing brand visibility and customer loyalty.

2. Which of the following does NOT describe how Kara has maintained their competitive advantage with their focus strategy?

   (a) SG has grown rapidly since its founding, expanding to 1113 stores in 93 markets (countries), making it one of the most successful fashion retail brands in the world.

   (b) SG's success is evident in the profitability of its founder, Mr. Goyal, who is the ninth richest man in the world.

   (c) SG spends only 0.8% of its sales on advertising, compared to an average of 5% spent by competitors.

   (d) SG follows a push model in their inventory and supply chain management to maintain its market position.

3. Can the Managing Director (MD) of a region, who is also an employee, be provided a salary under Ind AS.

   (a) No, because MDs are considered part of key management personnel and should be compensated differently.

   (b) Yes, because Ind AS 19 applies to all employees, including those in management positions, provided they are also employees of the company.

   (c) No, because Ind AS 19 only covers lower-level employees, not senior management.

(d) Yes, but only if the MD's salary is disclosed separately from other employees' salaries.

4. Enumerate the legal requirements for the remittance of commission by SG India to M/s. Best Broker and recommend the most appropriate legal position to ensure compliance with the relevant provisions of the Foreign Exchange Management Act, 1999:

(a) There is no requirement of obtaining prior permission of Reserve Bank of India (RBI) for remittance of commission upto USD 25,000 by SG India to M/s. Best Broker but for the balance commission of USD 24,000, prior permission of RBI is required.

(b) There is no requirement of obtaining prior permission of Reserve Bank of India (RBI) for remittance of commission upto USD 35,000 by SG India to M/s. Best Broker but for the balance commission of USD 14,000, prior permission of RBI is required.

(c) There is no requirement of obtaining prior permission of Reserve Bank of India (RBI) for remittance of entire commission of USD 49,000 by SG India to M/s. Best Broker in line with agreement.

(d) It is mandatory to obtain prior permission of Reserve Bank of India (RBI) for remittance of entire commission of USD 49,000 by SG India to M/s. Best Broker.

5. Which statement is TRUE regarding the application of Ind AS 102 (Share-based Payment) to Employee Stock Option Plans (ESOPs) and the issuance of shares to a charity?

(a) ESOPs are covered under Ind AS 102 only if employees receive shares as part of their employment benefits, regardless they are shareholders.

(b) Ind AS 102 does not apply to the issuance of shares to a charity without consideration, as it is not a share-based payment transaction.

(c) The issuance of shares to a charity without consideration is covered under Ind AS 102 as a share-based payment arrangement, while ESOPs are not covered if employees receive shares in their capacity as shareholders.

(d) ESOPs are covered under Ind AS 102 regardless of whether employees receive shares in their capacity as shareholders, and the issuance of shares to a charity without consideration is not covered under Ind AS 102.

II. Descriptive Questions

6. ANALYZE and EVALUATE how SG's approach to product differentiation contributes to its competitive advantage in the fast fashion industry.

7. STATE what would be the treatment of the short-term compensating absences, profit-sharing plan and the defined contribution plan in the books of SG. Also, STATE what would be the treatment, if the contribution paid from defined contribution plan exceeds the contribution due. Further, DETERMINE what would be the accounting if the payment from defined contribution plan does not fall due within 12 months from the end of accounting period.

8. The CFO of the company wants to know at what value would this asset be recognised in the books of accounts. PREPARE a statement showing him the workings.

ANSWERS TO THE CASE STUDY 2

I. Answers to the Multiple Choice Questions

1. (c) Backward vertical integration, by maintaining in-house production and control over the entire supply chain, allowing for rapid adjustments in production to meet market demands.

Reason: SG's backward vertical integration, which involves maintaining in-house production and supply chain control, allows for rapid and flexible production adjustments. This strategy is crucial in the fast-fashion industry, where quick response to market demands and trends is essential for maintaining a competitive advantage.

2. (d) SG follows a push model in their inventory and supply chain management to maintain its market position.

Reason: The company has grown rapidly, is highly profitable, spends very little on advertising, and relies on product quality and customer satisfaction rather than branding or persuasion. Moreover, follows a pull model in their inventory and supply chain management. They create multiple designs every month based on store sales and current trends. Therefore, option (d) does not describe correctly how SG has maintained their competitive advantage.

3. (b) Yes, because Ind AS 19 applies to all employees, including those in management positions, provided they are also employees of the company.

Reason: Ind AS 19 (Employee Benefits) covers all forms of employee benefits, including salaries, for individuals who are employees of the company, regardless of their position within the company. This includes senior management and key management personnel like Managing Directors, as long as they are classified as employees. Therefore, the MD of a region, being an employee, can be provided a salary under Ind AS 19.

4. **(d)** It is mandatory to obtain prior permission of Reserve Bank of India (RBI) for remittance of entire commission of USD 49,000 by SG India to M/s. Best Broker.

Reason: According to FEMA Act, 1999, persons other than individuals shall require prior approval of the Reserve Bank of India for remittance of Commission, per transaction, to agents abroad for sale of residential flats or commercial plots in India exceeding USD 25,000 or five percent of the inward remittance (USD 7,00,000x5%=USD 35,000) whichever is more. Here, in this case, commission is USD 7,00,000x7%=USD 49,000 which higher than USD 35,000.

5. **(c)** The issuance of shares to a charity without consideration is covered under Ind AS 102 as a share-based payment arrangement, while ESOPs are not covered if employees receive shares in their capacity as shareholders.

Reason: Since the employees who have received such shares are acting in the capacity of shareholders and not as employees, this transaction will not be covered under Ind AS 102. Further, entity issuing its own shares to a charity without any consideration will be covered under Ind AS 102.This is a share-based payment arrangement, covered under Ind AS 102 (not a share-based payment transaction).

II. Answers to the Descriptive Questions

6. SG's approach to product differentiation significantly contributes to its competitive advantage in several ways.

Firstly, SG's *rapid design-to-store turnaround*, where new designs appear in stores within two weeks of conception, ensures that the company constantly offers the latest fashion trends, attracting fashion-conscious consumers and setting SG apart from competitors who have longer production cycles. This quick response to market demands allows SG to keep its product offerings fresh and relevant, creating a sense of urgency and exclusivity among customers.

Secondly, SG's *vertical integration plays a crucial role in maintaining high product quality and control over the entire production process*. By keeping a substantial portion of its manufacturing in-house and located in South Asia, SG can quickly adjust production based on market feedback and emerging trends, reducing lead times and ensuring consistency in quality. This tight control over the supply chain enables SG to implement its innovative designs swiftly and efficiently, further differentiating its products from those of competitors who rely heavily on outsourcing.

Thirdly, SG gains a competitive advantage by selling its clothing exclusively through its own retail stores, strategically located to attract a high volume of customers. This strategy focuses on creating a unique and immersive shopping experience. SG's stores are designed to resemble high-end fashion boutiques, with carefully curated product displays

that enhance the sense of luxury and exclusivity. This approach not only differentiates SG from competitors but also reinforces its brand image and appeals to discerning customers seeking a premium shopping experience.

Fourth, SG has a highly evolved data infrastructure, that allows for super-efficient analysis of what's selling and being said on social media platforms. This data is used to improve various aspects of the business from product offerings to service enhancements. The two-way communication between the customer and SG allows for continual improvement of product and services. This is not common for designer clothes.

Lastly, SG's *dynamic pricing strategy* enhances its product differentiation by catering to various market segments. In the South Asian market, SG employs a penetrating pricing strategy to attract middle-class consumers, while in regions like Europe, SG adopts a premium pricing strategy to target wealthier consumers willing to pay a premium for fashion-forward items. This regional pricing flexibility allows SG to maximize its market reach and appeal to a broader customer base, strengthening its competitive position globally.

In summary, SG's rapid turnaround time, vertical integration, exclusive distribution channel and adaptable pricing strategy collectively reinforce its product differentiation, ensuring that the company remains a leading force in the fast fashion industry by consistently meeting and exceeding customer expectations.

Evaluation of Strategy

SG's success has come despite the fact they use almost no advertising. Only 0.8 percent of sales is spent on advertising, compared to an average of 5 percent spent by their competitors. Their founder, Mr. Goyal, has never spoken to the media nor personally advertised SG in any way. This points to the success of their products in satisfying the needs of the customers rather than through branding or persuasion. By making the brand experience meaningful and the exchange valuable, SG taps the potential of its customers to evangelize the brand. Therefore, SG has been immensely successful in maintaining their competitive advantage with their differentiation strategy.

7. **(a)** SG will recognise a liability in its books to the extent of 5 days of PL for 200 employees and 10 days of PL for remaining 800 employees and 2 days of SL for 200 employees and 5 days of SL for remaining 800 employees in its books as an unused entitlement that has accumulated in 2023-2024 as short-term compensated absences.

(b) SG will recognize ₹ 70 crores (₹ 2,000 x 3.5%) as a liability and expense in its books of account.

(c) When an employee has rendered service to an entity during a period, the entity shall recognise the contribution payable to a defined contribution plan in exchange for that service.

Under Ind AS 19, the amount of ₹ 80 crores will be recognised as a liability (accrued expense), after deducting any contribution already paid (100-20) and an expense in the statement of profit and loss.

However, if the contribution already paid would have exceeded the contribution due for service before the end of the reporting period, an entity shall recognise that excess as an asset (prepaid expense).

Since the contributions are payable within 12 months from the end of the year in which the employees render the related service, they will not be discounted. However, where contributions to a defined contribution plan do not fall due wholly within twelve months after the end of the period in which the employees render the related service, they shall be discounted using the discount rate.

8. In accordance with Ind AS 16, all costs required to bring an asset to its present location and condition for its intended use should be capitalized. Therefore, the initial purchase price of the asset should be:

List price	₹ 80,00,000
Less: Trade discount (10%)	₹ (8,00,000)
	₹ 72,00,000
Import duty	₹ 5,00,000
Delivery fees	₹ 1,00,000
Electrical installation costs	₹ 10,00,000
Pre-production testing (Net of Sale Proceeds of ₹ 1,00,000)	₹ 4,00,000
Total amount to be capitalized	₹ **92,00,000**

Maintenance contract is a separate contract to get service, therefore, the maintenance contract cost of ₹ 7,00,000 should be taken as a prepaid expense and charged to the profit or loss over a period of 5 years.

In addition, the settlement discount received of ₹ 3,60,000 (₹ 72,00,000 x 5%) is to be shown as other income in the profit or loss.

The operating loss incurred after commercial launch cannot be capitalised. Hence those figures are being ignored.

CASE STUDY 3

Refresh Tea Ltd. (RTL) was established in 1935 and headquartered in Kolkata. The company owns several plantations in North-East India (Assam and West Bengal) and South India (Kerala, Tamil Nadu, and Karnataka). It started out as a producer of tea leaves. They have their own processing centre within their plantation estates (or tea gardens) to dry, ferment, and cut the tea leaves. The company would then auction the leaves to traders, who in turn would sell them to tea companies (downstream supply chain) in order to be blended, packed, and resold to the customer. RTL continued to be a producer of tea leaves until the mid-1980s, until which time it only auctioned the tea leaves to the traders.

Over the decades, the popularity of tea as a beverage increased manifold due to clever and attractive marketing campaigns. Marketed as a health drink that could provide relief for ailments like cold, flu or body ache, tea as a beverage slowly became popular across the country. Tea has both an organized branded (pre-packaged) market as well as unorganized unbranded market (loose lot sale). Different versions of brewing and making tea were practiced, and this concocted a success story of exponential proportion.

Increasing popularity of the beverage prompted RTL to expand the scope of its business. It wanted to continue its plantation business, but now it also wanted to expand its business to include the blending, packaging, and marketing of tea. RTL would increase the production of tea leaves in its plantations using both its existing estates as well by acquiring newer tea estates to increase production capability. All tea leaves will be processed further (dried, fermented, and cut) at the processing centres within its plantations. The management of RTL decided that it would from this point, also start blending, packaging, and marketing its own tea. For this, it built and gained ownership of the necessary factory resources and infrastructure for blending, packaging, and marketing its tea. Production resources and infrastructure were owned and controlled by RTL. This packaged tea will be sold directly to wholesalers and retailer dealers who would in turn sell it to the final customer.

When RTL decided to become a full-fledged tea company by the mid-1980s, the market was saturated with many sellers. Most of them bought tea leaves from traders at various auctions, blended, packaged, and marketed the tea. For these other suppliers, it took approximately 80 days from the time the tea leaf was plucked to the time the consumer purchased it. They catered to consumers from all strata of society. Premium tea dominated the branded market, while people who could not afford it were satisfied with the unbranded loose tea that could be bought as per their individual requirements. RTL decided to establish itself in the branded market.

Unbranded loose tea was perceived to be of lesser quality as compared to branded pre-packaged tea and therefore could not command much price in the market.

RTL conducted detailed market research and found that consumers from different regions had different taste preferences. For example, consumers in Bihar and Jharkhand preferred tea leaf while consumers in Maharashtra and Gujarat preferred tea dust. RTL therefore created different brands that catered to different markets (in terms of taste preference - leaf or dust tea) as well as different price bands (economy or premium). The quality of RTL's pre-packaged branded tea was kept higher than the unbranded tea sold in loose lots, and at the same time, the price of its packaged tea was kept slightly lower than the other premium varieties available in the market. Thus, RTL decided to place itself in the middle of this market spectrum in terms of quality and cost. So, it sold premium brand leaf tea as well as economy brand leaf tea in Bihar and Jharkhand, while it sold premium dust tea and economy dust tea in Maharashtra and Gujarat. As part of its marketing strategy, it created a separate brand for each target customer audience so that the quality and price could be easily recognized by the end user. RTL further aimed to deliver the tea to the final customer within 20 days from the time the tea leaf was plucked from its gardens.

The new vision statement of RTL was then reframed as *"to be the most admired tea company across the globe."*

The new mission statement of RTL was then reframed as ***"to enhance customer experience by making tea a global beverage of choice. Understand and influence tastes and preferences by bringing unique, quality, affordable tea to the discerning palate of customers."***

Today, in 2023, the total Indian tea market is estimated to be ₹ 34,400 crore, with branded businesses constituting approximately 74% of the total market value. The global tea market is estimated to be $45-50 billion, with the main demand coming from the black tea segment. RTL has emerged as the market leader, commanding 60% of the domestic Indian tea market. It is now a listed company at BSE and NSE stock exchanges. Demand in other segments like green tea, fruit & herbal, decaf, and speciality tea among others is also picking up. Taking note of this new trend, RTL conducted market research and a survey done of the entire beverage industry to gather market intelligence and emerging customer choices. The findings reveal that consumers are becoming more health conscious in their choices. In the past 2 years, demand for fruit juices, coconut water, almond milk, and milk shakes has increased. According to the study, the shift towards healthier beverage choices like fruit juices, coconut water, almond milk, and milkshakes is projected to grow and encompass at least 8% of the beverage market within the next three years.

Tea King Plc. (TKP) is a UK based company that produces tea bags. Small sachets of tea (tea bags) are dipped into hot water in order to brew conveniently within a cup. The sachets can be conveniently disposed of after use. Tea bags are hugely popular across the globe, primarily due to the convenience of use and disposal. "Anywhere-Anytime" is a highly recognized tagline for TKP's tea bags. The company has a net worth almost three times that of RTL. TKP has a deep market presence in the United Kingdom and the United States of America, as well as a few other European countries where tea is relished as a beverage. Despite its huge global presence and scale, the ownership of TKP has changed hands frequently every few years. This is because the profitability of the business is constantly under pressure due to the high input costs of tea, driven by inflationary conditions. TKP imports tea leaves (its raw material) from various countries, and the cost of imports has become more expensive over the years.

RTL has recently gained the opportunity to own a controlling stake in TKP. This is a prestigious development for RTL, as it has been trying to increase its global footprint, particularly in the UK and USA. The advantage the company has that most of the previous owners of TKP did not have, is that RTL has better control over the supply of raw materials. India is one of the major tea producing countries. RTL has been in the plantation business since its inception. Hence, RTL is much better positioned to scale up tea leaf production to meet TKP's raw material requirements in a cost-effective way, thereby countering any inflationary pressure. However, since the size of the deal is much bigger than even RTL's net worth, it has to resort to taking significant amount of debt to finance the deal. The deal has the approval of the majority shareholders, and other regulatory approvals are in place.

In the dynamic field of tea production, external factors such as unpredictable weather conditions can severely affect operations. Recognizing the importance of proactive risk management, RTL has implemented a comprehensive strategy to mitigate potential disruptions and protect its plantations specifically in northeastern region. This includes ensuring adequate insurance coverage, positioning RTL to effectively navigate the uncertainties associated with cyclones and adverse weather events. RTL's financial statements are prepared in accordance with Indian Accounting Standards (Ind AS) notified under the Companies Act, 2013.

I. Multiple Choice Questions

1. Which of the following statement is true regarding the current expansion plan of RTL (acquisition of TKP) and the expansion of RTL in the mid-1980s?

   (a) Current expansion plan of RTL (acquisition of TKP) is horizontal integration, while expansion in the mid-1980s is vertical integration

   (b) Current expansion plan of RTL (acquisition of TKP) is vertical integration, while expansion in the mid-1980s is horizontal integration

(c) Current expansion plan of RTL (acquisition of TKP) and the expansion in the mid-1980s are both vertical integration

(d) Current expansion plan of RTL (acquisition of TKP) and the expansion in the mid-1980s are both horizontal integration

2. The regulatory authorities in India have to assess whether there is any breach of the anti-competition laws. Which type of stakeholder will the regulatory authorities be classified as using Mendelow's Matrix?

(a) The regulatory authority is a marginal player with low interest and low power

(b) The regulatory authority is a key player with high interest and high power

(c) The regulatory authority is an influencer with low interest and high power

(d) The regulatory authority is an affected player with high interest and low power

3. **TKP** has used the tag line "Anywhere-Anytime" to market its tea bags. With reference to the value proposition map, please match the following –

Particulars	Element of the value proposition map
a. Brewing tea	i. Customer Profile: Gain
b. Customer health	ii. Value Map: Gain Creator
c. Green tea	iii. Value Map: Pain Reliever
d. Tea bag	iv. Customer Profile: Pain

Options

(a) i, b- ii, c- iii, and d- iv

(b) i, b- iv, c- iii, and d- ii

(c) iv, b- i, c- iii, and d- ii

(d) iv, b- i, c- ii, and d- iii

4. The blending machine at Nagaon (Assam) Factory blends tea leaf varieties produced in the plantations of RTL. Due to increased seasonal demand during the monsoon, the production of tea increases in this factory for the months of May, June, and July. Due to this, the availability of time on the blending machine is limited during these months. There is no immediate plan to increase the blending machine capacity since this is a seasonal variation in demand, and hence the constraint is short term in nature. At the same time, the production manager at Nagaon Factory wants to determine the order and quantity of

tea blend to produce in order to maximize profits. The selling price and cost per kg., as well as bottleneck production details are as below:

Particulars	Blend 1	Blend 2	Blend 3
Selling price (in ₹)	500	600	800
Material and other variable cost (in ₹)	300	400	500
Time required at the blending machine (minutes); Bottleneck resource time	20	30	40

The factory cost is ₹ 5 per minute. The manager wants to rank the blends based on the throughput accounting ratio. This will be used to plan the production schedule for the months when blending time is a bottleneck constraint.

Which of the following statements is true?

(a) Ranking based on throughput accounting: Rank 1 – Blend 1, Rank 2 – Blend 2, and Rank 3 – Blend 3

(b) Ranking based on throughput accounting: Rank 1 – Blend 1, Rank 2 – Blend 3, and Rank 3 – Blend 2

(c) Ranking based on throughput accounting: Rank 1 – Blend 2, Rank 2 – Blend 1, and Rank 3 – Blend 2

(d) Ranking based on throughput accounting: Rank 1 – Blend 3, Rank 2 – Blend 2, and Rank 3 – Blend 1

5. RTL has divisions like plantation, processing, blending, packaging, etc. The popularity of tea has increased the demand for tea leaves in the market. Many tea companies do not own any plantations of their own. They purchase the tea leaf directly from the tea auctions. RTL uses only the tea leaf produced within its own plantations in order to have control over the quality and price of different tea blends. The tea leaves, once plucked, are transferred to the processing units within the plantations. The company has a transfer pricing policy for any internal transfer within the divisions. Plantations are producing at their full capacity. Brokers from the external market are offering the plantation division a price of ₹ 200 per kg. of plucked tea leaves, while the marginal cost of production has been determined at ₹ 170 per kg. The net marginal price (selling price – marginal cost) at the processing division is ₹ 210 per kg., while the price at which the processing centre can purchase tea leaves (procurement price of similar quality) from other plantation suppliers is ₹ 205 per kg. Note, selling price for the processing division is actually the transfer price it charges the blending division for each kg. of processed tea.

The managers of each unit have their performance assessed based on the surplus each division generates. Which of the following transfer pricing range will bring goal congruence between the plantation division and the processing division?

(a) Minimum ₹ 170 per kg. – maximum ₹ 210 per kg. of tea leaves

(b) Minimum ₹ 200 per kg. – maximum ₹ 210 per kg. of tea leaves

(c) Minimum ₹ 200 per kg. – maximum ₹ 205 per kg. of tea leaves

(d) Minimum ₹ 170 per kg. – maximum ₹ 205 per kg. of tea leaves

6. In August'2023, RTL's tea estate in Jellalnagar, Karimganj district, received ₹ 10,00,000/- as compensation from an insurance company for severe damage to green leaves caused by a hailstorm. A trainee accountant (tax) at the Head Office believes that the entire receipt under the insurance policy, pertaining to damage caused by the hailstorm to tea leaves, will be assessable as income from other sources. Evaluate this view.

(a) The accountant's view is correct; the entire compensation is assessable as income from other sources.

(b) The accountant's view is incorrect; no part of the compensation consists of manufacturing income, and it cannot be apportioned under rule 8 between manufacturing income and agricultural income. Therefore, income will be agricultural income.

(c) The accountant's view is incorrect; only a portion of the compensation is assessable as business income.

(d) The accountant's view is incorrect; the entire income would be treated as business income.

II. Descriptive Questions

7. The induction program for new hires is underway. They are being introduced to the history of tea in India as well as how RTL grew to be a leading player in this market. One of the new inductees asks:

"What is the rationale behind RTL's decision in the mid-1980s to expand its operations into a saturated market? It could have maintained the status quo as a plantation company producing tea leaves. Why did it have to get into the blending, packaging, and marketing business as well? Also, how did RTL manage to become a market leader despite the competition?"

Required

You are being the Deputy Manager (Finance & Strategy) at RTL, have been requested to provide your explanation behind the rationale behind this business decision taken in the mid-1980s. Also, based on the information in the case study, ASSESS the company's success in a competitive market.

8. At RTL's Darjeeling plantation site, manufacturing process commences with the plucking of tea leaves from the plantation. Once the tea leaves are harvested, they are transported to the internal processing centres to continue the manufacturing process.

The local accountant at the site is currently preparing site's financials in accordance with Indian Accounting Standards (Ind AS) under your supervision.

Required

She has raised the following questions −

(i) Whether these plucked tea leaves are agriculture produce as per Ind AS 41 or not?

(ii) How should such plucked tea leaves be initially measured?

(iii) What will be subsequent measurement of such tea leaves in line with Ind AS 41 and Ind AS 2? [VERB- APPLY].

9. In the process of preparing the financial statements for the financial year ending on 31.03.2023, the management of RTL has made several accounting estimates and affirmed to the auditor that all necessary accounting estimates have been recognised, measured, and disclosed in the financial statements are in accordance with the applicable financial reporting framework. However, in the course of the audit, auditor has observed some changed circumstances giving rise to the need for an accounting estimate.

Required

ENUMERATE some circumstances, change of which would prompt inquiries from the management of RTL.

ANSWERS TO THE CASE STUDY 3

I. Answers to the Multiple Choice Questions

1. (a) Current expansion plan of RTL (acquisition of TKP) is horizontal integration, while expansion in the mid-1980s is vertical integration.

Reason: TKP is in the same business as RTL. There is a difference, TKP produces tea bags while RTL produces tea packages. However, both belong to the same industry, catering to different requirements within the tea market. The acquisition of TKP will help RTL grow in size and revenue by diversifying into new markets with newer products of tea. Therefore, this is a horizontal integration.

The expansion of RTL in the mid-1980s to include other processes in the value chain like blending, packing, and marketing is a vertical integration. RTL, at that point in time, was only in the plantation business. As expanded into other activities in order to get better control of the supply chain, RTL gained control over additional processes in the production of tea as well as the cycle time to deliver to customers. This helped to penetrate the existing tea market in India. This is vertical integration.

2. (c) The regulatory authority is an influencer with low interest and high power.

Reason: The authorities have a low interest in whether the acquisition is successful or not. However, they have a high power since if there is any indication that this acquisition can give RTL unfair advantage to stifle competition, they can refuse to approve the acquisition deal or may take action against the business. Hence, enough information should be provided to keep them satisfied in order to not face any adverse action.

3. (d) a- iv, b- i, c- ii, and d- iii.

Reason:

Brewing tea is a pain that the customer faces; Customer Profile: Pain.

Customer Health is a gain or aspiration for the customer; Customer Profile: Gain.

Green tea addresses the customer's aspiration for good health; Value Map: Gain Creator.

Tea Bag brings the convenience of brewing tea anywhere at anytime; Value Map: Pain Reliever.

4. (b) Ranking based on throughput accounting: Rank 1 – Blend 1, Rank 2 – Blend 3, and Rank 3 – Blend 2.

Reason: The calculation is as below:

Particulars	Blend 1	Blend 2	Blend 3
Selling Price (in ₹)	500	600	800
Less: Material and Other Variable Cost (in ₹)	300	400	500
Throughput Contribution (in ₹)	200	200	300
Time Required at the blending machine (minutes)	20	30	40
Contribution per minute (in ₹)	10.00	6.66..	7.50
Factory Cost *per minute* (in ₹)	5	5	5
Throughput Accounting Ratio (*TA Ratio = Contribution per minute / Factory Cost per minute*)	2.00	1.33..	1.50
Ranking as per TA ratio	I	III	II

5. (c). Transfer price range for tea leaves should be minimum ₹ 200 per kg. – maximum ₹ 205 per kg. of tea leaves.

Reason: The plantation division is operating at full capacity, with an external demand for its tea leaves at ₹ 200 per kg. Hence, although its marginal cost is only ₹ 170 per kg., it should charge the opportunity cost of ₹ 30 per kg. that it would have earned had it otherwise sold in the external market. For the processing division, tea leaves can be bought externally at ₹ 205 per kg. Hence, although its net marginal revenue is ₹ 210 per kg., that it can afford to pay upto ₹ 210 per kg. and still remain profitable, the division will be unwilling to pay beyond ₹ 205 per kg. (external procurement price). Hence, the transfer price range that can promote goal congruence will be minimum ₹ 200 per kg. – maximum ₹ 205 per kg. of tea leaves.

The ideal transfer price should be ₹ 200 per kg. which will give the plantation division the normal profit it would have otherwise earned from external sales, while the processing unit can procure it at a much lower cost than the external buy-in price. The transfer price will be negotiated by the managers of the respective division; hence, the final price within the above range will depend on the bargaining skills of each manager.

6. (b) The accountant's view is incorrect; no part of the compensation consists of manufacturing income, and it cannot be apportioned under rule 8 between manufacturing income and agricultural income. Therefore, income will be agricultural income.

Reason: Compensation received from an insurance company for damage caused by hailstorm to the green leaf is fully agricultural income and no part of such compensation consists of manufacturing income. Therefore, cannot be apportioned under rule 8 between manufacturing income and agricultural income.

II. Answers to the Descriptive Questions

7. In a competitive environment, a business must craft its strategies not just to survive but also to sustain itself. RTL started out as a tea leaf producer, owning plantation tea estates to grow tea. While it had control over the production, it did not have as much control over the price at the auction. If you refer to scheme of Supply Chain for Tea, it is the brokers who had more influence over the auction price as they had more complete information about both the supply and demand for tea. Hence, the revenue generation flexibility for RTL was being limited by the influence of brokers, who acted as the middlemen for the plantation owners (tea growers) and the tea companies (tea blenders and marketers). Over the decades, the popularity of tea as a beverage increased the competition. Recognizing this change, the management of RTL had to study the external environment and understand how it could determine its strategy in order to survive and thrive within this competitive business. RTL became agile and responsive to change. This resilience made it competitive and became the primary reason for its success in the competitive market.

Concept Insight

The study of the external environment requires the study of the remote environment and operating environment of the industry including the competitive environment. To analyse the operating environment of an industry, it is important to consider all the factors that affect profitability as well as the competitive position of business organisations within it. These factors can be grouped into elements such as customers, competitors (existing as well as potential entrants), suppliers, advocacy groups, regulations, regulatory groups, and many other elements such as industry life cycle, supplier's suppliers, and buyer's buyers, etc. Basically, it considers the wider picture through factors that are capable to decide the growth trajectory in addition to future profitability. Intensity of industry competition can be understood using Michael Porter's five forces model.

Porter's five forces helped RTL to identify where power lied in business situation. This was useful both in understanding the strength of RTL's current competitive position and the strength of a position that RTL might consider entering.

The five forces that were enumerated by this model are given below:

Threat of new entrants: Tea as a beverage was gaining popularity, so demand growth was increasing at an exponential pace. In turn, this made the industry attractive for new players to enter. This meant that competition in the market was likely to increase across the value segments (including the production of tea leaves) within the tea industry. RTL was an incumbent in this sector, as it already owned many plantations for producing tea leaves.

To Counter Competition, the management expanded its scale of operations. It increased the production of tea leaves (the raw material source) and branched out into allied processes within the industry value chain like blending, packaging, and marketing. It also owned and controlled its resources. This increase in scale of operations gave it a competitive advantage that not many new entrants may have had.

Bargaining power of suppliers: As mentioned in the case, many of the sellers in the saturated tea market bought tea leaves from traders at various auctions, blended, packaged, and marketed the tea. These brokers at auctions could influence the price of tea since they had information on both the demand and supply sides of the business. RTL was already a supplier of tea leaves (the raw material) and had wanted to branch out further in the industry value chain by expanding its operations. Moreover, it wanted to reduce the operating cycle by delivering good quality tea to the customers within 20 days. As part of its brand strategy, RTL also wanted to bring variety to its product offerings in terms of both quality (premium vs. economy) and type (leaf vs. dust). Uninterrupted supply of appropriate quality tea leaves is a critical requirement to ensure both a quick operating cycle and ability to produce a variety of tea catering to different brand requirements.

Therefore, it increased the scale of its production of tea leaves (raw materials) by increasing production in existing plantations as well as acquiring newer plantations. Ownership of these plantations gave the company better control over the supply of tea leaves. Unlike other sellers in the market, it did not depend on auctions to procure tea leaves. All this helped it to gain control over the supply of its tea leaf requirements. Reduced dependency on auctions or other suppliers also contributed to its success.

Bargaining power of buyers: RTL entered a market that was both saturated and highly competitive. When RTL entered the market, there was a premium segment and an economy segment. The presence of many suppliers indicates that buyers had a choice to switch between different tea offerings; therefore, there was no preference for a specific

brand. In order to build a loyal customer base, RTL had to differentiate itself from other tea offerings.

RTL redefined itself with as a customer centric business model. The quality of tea was kept higher than in the unbranded category by reducing the operating cycle and ensuring that the tea reaches the customer in its freshest form. At the same time, the price of its tea was kept lower as compared to other premium tea in the market. Its multi brand strategy, based on different quality and price expectations, helped it to connect with the different sets of customers, each with unique tastes and preferences. Each brand had a unique identity that the customer could easily understand and know what to expect from the product. This multi brand strategy established an important connection with the end user, helping it build a loyal customer base.

Threat of substitutes: Until the recent year, there was no immediate threat of substitute.

Rivalry among existing firms: Rivalry was addressed by RTL by changing its scope and scale of business operations so that it could exercise better control over different processes in the value chain. Having better control over supply side of business while having the resources to remain agile to the requirements of the demand side of business helped RTL become a leader in the market despite the competition.

Overall, RTL used its multi brand strategy, based on different quality and price expectations, to help build a product differentiation strategy. By expanding its operations into other processes in the value chain like blending, packing, and marketing, the company could study about the variety and change in taste and preferences of customers. This gave the company more credible information about the demand side of the business. The company could segment the market based on certain criteria so that customer demand could be catered to by addressing their unique needs. This customer centric business model for RTL helped it identify differentiating factors that can help it beat competition.

8. (i) **Paragraph 3 of Ind AS 41, Agriculture states that:** Ind AS 41 is applied to agricultural produce, which is the harvested produce of the entity's biological assets, at the point of harvest. Thereafter, Ind AS 2, 'Inventories' or another applicable Standard is applied. Accordingly, Ind AS 41 does not deal with the processing of agricultural produce after harvest; for example, the processing of grapes into wine by a vintner who has grown the grapes. While such processing may be a logical and natural extension of agricultural activity, and the events taking place may bear some similarity to biological transformation, such processing is not included within the definition of agricultural activity in Ind AS 41.

In the given case, RTL produces tea by processing tea leaves after they are plucked from tea plants, i.e., after they are harvested. Accordingly, any processing of harvested agricultural produce (processing of tea leaves into tea) will not be within the scope of Ind AS 41 as per aforementioned paragraph 3 of Ind AS 41.

Paragraph 5 of Ind AS 41, 'Agriculture' defines agricultural produce:

As per the standard as the harvested product of the entity's biological assets.

A biological asset is a living animal or plant.

Based on above definitions, at the point of harvest, the plucked leaves are the harvested product of tea plants which are the biological assets of RTL, hence such plucked tea leaves are agricultural produce as per Ind AS 41.

(ii) **Paragraph 13 of Ind AS 41 states that:** Agricultural produce harvested from an entity's biological assets shall be measured at its fair value less costs to sell at the point of harvest. Such measurement is the cost at that date when applying Ind AS 2 'Inventories' or another applicable Standard.

Therefore, in line with paragraph 13 of Ind AS 41, the fair value less costs to sell of the plucked leaves at the point of harvest would be the cost of such plucked leaves at the date of applying Ind AS 2.

(iii) Subsequently, such plucked tea leaves will be measured as inventory as per the accounting principles of Ind AS 2, 'Inventories'.

9. As per SA 540, "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures", inquiries of management about changes in circumstances may include, for example, inquiries about whether:

- The entity has engaged in new types of transactions that may give rise to accounting estimates.
- Terms of transactions that gave rise to accounting estimates have changed.
- Accounting policies relating to accounting estimates have changed, as a result of changes to the requirements of the applicable financial reporting framework or otherwise.
- Regulatory or other changes outside the control of management have occurred that may require management to revise, or make new, accounting estimates.
- New conditions or events have occurred that may give rise to the need for new or revised accounting estimates.

During the audit, the auditor may identify transactions, events and conditions that give rise to the need for accounting estimates that management failed to identify. SA 315 deals with circumstances where the auditor identifies risks of material misstatement that management failed to identify, including determining whether there is a significant deficiency in internal control with regard to the entity's risk assessment processes.

CASE STUDY 4

Becky Bond India Limited produces internationally successfully 'Becky' and 'Bond' brand of fashion clothes respectively for woman and men. The company has acquired a global reputation for good-quality, well-designed and reasonably priced fashion clothing. Like other fashion clothing companies, Becky Bond continually design and produce new clothes for the fashion market. During the course of one year, the company produces over 15,000 new fashion designs, and it has a large team of fashion designers. The company's top designers, who are based in Paris and Moscow, have an international reputation. These top designers bring international acclaim and expertise, further enhancing the brand's appeal and global market presence.

Becky Bond India Limited has established itself as a leader in the global fashion industry, renowned for its innovation, quality, and style. The company's success is built on a foundation of meticulous craftsmanship and a keen eye for emerging fashion trends. Becky Bond's clothing lines, known for their sophisticated designs and high-quality materials, resonate well with both fashion-forward consumers and those seeking classic styles. This dual appeal has allowed Becky Bond to carve out a significant niche in the crowded fashion marketplace. Becky Bond is not just a clothing manufacturer; it is a trendsetter in the fashion industry. By hosting fashion shows in major cities around the world and participating in international fashion weeks, Becky Bond showcases its latest designs to global audiences, influencing fashion trends and setting new standards in design excellence.

The company's distribution strategy is as robust as its design capabilities. Becky Bond primarily sells its products through a network of retail stores, some of which are company-managed, ensuring a consistent retail experience that aligns closely with the brand's identity. In addition to these dedicated stores, the company also partners with major department stores, securing dedicated spaces to reach a broader audience. This dual-channel retail approach allows Becky Bond to maintain strong control over its brand while also benefiting from the extensive foot traffic and customer base of larger retail establishments.

Currently, the company operates its own retail stores, with the number increasing each year, while its presence in department stores is declining annually. Most of these stores are located in Mumbai. Sales from Pune currently account for less than 10% of the company's total sales. As a prototype, the company has also established 'e-shops' for online selling.

Becky Bond India Limited stands as one of India's leading branded fashion and lifestyle entities, with an impressive portfolio of top fashion brands. As the country's leading pure-play fashion

powerhouse, the company commands over 10.8 Mn. Sq. ft. of retail space. This strong and vast infrastructure ensures that the company meet the growing needs of expanding base of brand-conscious consumers. The performance of company in FY20X2-X3 is a testament to resilience and determination. After weathering the impacts of the pandemic for two years, Becky Bond India Limited have made significant strides in both expansion and sales growth, surpassing the previous year's figures despite the macroeconomic challenges that dampened demand in the fiscal year's second half. The success has been driven by a targeted approach to growth, prioritizing distribution expansion, product innovation, customer engagement, and brand enhancement. The company's last year revenue witnessed a 53% YoY growth and EBIDTA growth of 34% over the last year.

Although all clothing products are designed by the company's own staff, most manufacturing is outsourced to small manufacturing companies. Most of these manufacturers are located in Nagpur or Thane. The company's policy of relying on large numbers of small suppliers has been successful in the past, but more recently there has been disagreements with a number of suppliers who have been demanding higher prices for their work due to increases in their own costs. The rising prices of cotton and fuel in particular have been a cause of concern for manufacturers. Becky Bond India Limited also has its own manufacturing subsidiary, located near Pune, but this produces less than 5% of the company's total annual requirements by volume.

Becky Bond's strong reputation in the market has been built largely on the success of its fashion designs. The company displays its fashions regularly at the major fashion fairs around the world, and its design team members are continually searching for new fashion ideas. Most fashion products are designed in advance of each season, and there are four fashion seasons each year. Orders are placed with manufacturers and the manufactured items are delivered to a central distribution centre that the company operates near Pune. Goods are either sent to department stores direct from Pune, or they are sent to a subsidiary distribution centre, from where they are sent to company's own stores and department stores. However, many department stores reduced their pre-orders of items in 20X4-20X5 and placed additional (supplementary) orders with the company later in the fashion season, when they knew what items were selling well and which were not.

The company's design team have been experimenting with a new just-in-time (JIT) system of purchasing and production for some of its fashion items. This JIT system is similar to the system used by the international fashion goods producers. With this system, only limited quantities of products are manufactured for the start of each season. Members of the sales team in each

region check the strength of demand for each product and inform Head Office in Pune which products are selling well, and which are selling badly. Orders for additional quantities of the popular items are then placed with manufacturers and distributed as quickly as possible to meet the sales demand. Experiments with this Just-in-time purchasing/manufacturing system have been only partially successful, due to the long lead time between placing orders with small manufacturers and getting delivery into the distribution centre near Pune.

The Company was listed on 28 September 20X3 on the BSE. Before the upcoming Board Meeting post listing, the CFO called two of his team members – Aarti and Namrata who are expert in financial reporting and business strategy. Namrata mentioned that the Company's Board of Directors set a financial target to achieve a 20% increase of EBITDA to sales each year. It is disappointing that this target could not be achieved, and alternative strategies to improve financial performance should be considered. Namrata also mentioned that overall, the company reported PBT in the current quarter and losses are expected thereafter. The following table shows the quarterly loss/ profits:

INR lakhs

	QE June 20X3	QE September 20X3	QE December 20X3*	QE March 20X4*	Year ended 20X3 to 20X4*
Profit before tax	(350)	850	(300)	(200)	Nil

**Projected*

Namrata further mentioned that SEBI (LODR) Regulations, 2015 have prescribed a format for submitting financial results. Namrata has prepared the financial results as follows:

INR lakhs

	QE September 20X3	*QE June 20X3	*QE September 20X2	YTD September 20X3	*YTD September 20X2	*Year ended 31 March 20X3

****The Company was not listed in these period***

Besides, Becky Bond Limited also established a grievance redressal mechanism to address investor complaints. It mandated the filing of a statement detailing these complaints, as well as other corporate governance requirements, and the submission of quarterly statements to the stock exchange covering matters related to public issues, rights issues, preferential issues etc. in November 20X3.

Aarti mentioned that Pune has been identified as an important region for future growth, but there are possibilities for further expansion in Mumbai as their disposable income have improved. The Design Director believes that the company should review its product range and change the emphasis of its sales efforts from some products to others.

The CFO mentioned that the main competition for Becky Bond are from 'Gen Z', 'Caterpillar' and 'Beat It'. Gen Z's success has been built on a rapid product development cycle and a fast production cycle based on JIT. It uses a large number of small manufacturers in the same area, where 'Gen Z' has a large and modern distribution centre. 'Caterpillar' has also been highly successful in the Mumbai fashion market. 'Beat It' has been left behind these two rivals, but is trying to recover lost ground through an expensive advertising campaign and refurbishment of many of its stores. 'Beat It''s turnover has doubled in the past decade, whereas the turnover at the company has risen 3-fold, 'Caterpillar' has increased 4-fold and at 'Gen Z' by six times. 'Beat It' faces a significant challenge, as does the Company: in the large Mumbai market, their relatively slow design and distribution systems cannot keep up with consumer demand for fast, affordable copies of the latest popular fashions. Almost half of 'Beat It''s sales occur in Mumbai. However, the company is developing a strategy for further expansion in Pune, where its brand name is very strong. The CFO mentioned that the Board is considering a number of alternative strategies to improve company performance including the following:

- Expand business in Pune as quickly as possible and aim to acquire a 25% share of the market for fashion goods within 5 years. A strategic problem with expanding in Pune is that customers are used to paying much lower prices for their clothes, and it may be necessary to develop a new line of products with a new brand name, to sell at lower prices. The market for fashion goods is relatively new and is still developing, as levels of wealth among consumers in Pune rise. In order to gain market share Becky Bond will probably have to enter into a strategic alliance or a merger with a partner in the Pune, which has an established brand name and an extensive distribution network.
- Expand business in South Mumbai with the company's existing product ranges. There are several ways in which this might be done. One approach would be to improve the shopping experience for customers by investing more in stores and customer service, in order to increase sales volume. Alternatively, the company could develop new methods of sales and distribution, particularly online sales.
- Developing new product ranges for existing markets. Senior members of the design team are excited about the sales potential for "environmentally friendly fashion" or "sustainable fashion", and for other product ranges such as denim fashion goods, which the company

only recently began to design and sell. Sunglasses and swimwear are also considered to be potential areas for new product development.

Consolidation strategy based on improving efficiency and reducing costs. There are several ways in which this might be achieved. One strategy would be to consolidate the sourcing of goods, and using a smaller number of suppliers, in order to achieve lower prices in return for bigger orders.

I. Multiple Choice Questions

1. By what time should Becky Bond India Limited submit financial results for the QE September 20X3 to the stock exchange?

   (a) Submission of financial results is not required since the Company has listed few days before end of the quarter.

   (b) Submission of financial results is required within 45 days from the date of listing.

   (c) Submission of financial results is required within 45 days from the end of the quarter.

   (d) Submission of financial results is required within 60 days from the end of the quarter.

2. Which of the following is an unpublished price sensitive information as per SEBI (Prohibition of Insider Trading) Regulation, 2015?

   (a) Financial Results

   (b) Changes in finance and accounts team

   (c) Significant improvement of business of an immaterial subsidiary

   (d) Submitting Annual Report to Stock exchange

3. Becky Bond India Limited had the start in the quarter with the listing of it with 5 investor complaints. During the quarter, it received 15 new complaints. By the end of the quarter, it resolved 12 complaints. Determine how many investor complaints remain unresolved at the end of the quarter?

   (a) 5

   (b) 8

(c) 15

(d) 3

4. As per the SEBI(LODR)Regulations, 2015, company must submit its quarterly compliance report on corporate governance. The quarter ended on 31st March 20X4. By which date should it submit its compliance report to the BSE?

(a) 15th April 20X4

(b) 21st April 20X4

(c) 22nd April 20X4

(d) 30th April 20X4

5. Why is it necessary for Becky Bond to create a separate brand for lower-priced products when expanding in Pune?

(a) To increase the production cost of the existing brand's products.

(b) To align with the high pricing strategy of the existing brand.

(c) To avoid diluting the premium image of the existing brand.

(d) To compete with luxury fashion brands in Pune.

6. When should Becky Bond Limited submit its shareholding pattern statement to the recognized stock exchange?

(a) 8th November 20X3

(b) 20th November 20X3

(c) 19th November 20X3

(d) 31st March 2024

II. Descriptive Questions

7. The applicable income tax rate is 30%. The CFO is of the view that the no tax expense should be recognised in the quarter and year to date ended 30 September 20X4 as no income tax is payable for the entire year? Is the CFO correct and if not, please describe your rationel and also state the amount of income tax that should be recognised?

8. Assess the competitive environment in the segment of the fashion industry in which Becky Bond operates using Porter’s Five Forces model.

9. EVALUATE the supply chain of Becky Bond, identifying its current weaknesses and suggesting ways to overcome them.

ANSWERS TO THE CASE STUDY 4

I. Answers to the Multiple Choice Questions

1. **(c)** Submission of financial results is required within 45 days from the end of the quarter

Reason: Regulation 33(3) of SEBI (LODR) Regulations, 2015 requires submission of financial results within 45 days from the end of the quarter other than the last quarter.

2. **(a)** Financial Results

Reason: Under Regulation 2(1)(n) of SEBI (Prohibition of Insider Trading) Regulation, 2015 financial results is an unpublished price sensitive information.

3. **(b)** 8

Reason: At the beginning of the quarter, there were 5 complaints. During the quarter, 15 new complaints were received, making a total of 20 complaints. Out of these, 12 were resolved, leaving 8 unresolved (20 - 12 = 8).

4. **(b)** 21st April 20X4

Reason: According to Regulation 27(2), the listed entity must submit the quarterly compliance report on corporate governance within 21 days from the end of the quarter. Since the quarter ended on 31st March 20X4, the deadline is 21st April 20X4.

5. **(c)** To avoid diluting the premium image of the existing brand.

Reason: By introducing a new line with a different brand name, Becky Bond can cater to the price-sensitive market in Pune without compromising the perceived value and exclusivity of its original brand.

6. **(b)** 20th November 20X3

Reason: According to Regulation 31(1), the listed entity must submit the shareholding pattern statement, within 10 days of any capital restructuring, which would be by 20th November 20X3 (10 days after 10th November 20X3).

To comply fully with the regulation, the company should submit the shareholding pattern statement by 20th November 20X3

II. Answers to the Descriptive Questions

7. Paragraph 30(c) of Ind AS 34, income tax expense is recognised in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year. Amounts accrued for income tax expense in one interim period may have to be adjusted in a subsequent interim period of that financial year if the estimate of the annual income tax rate changes.

The general approach of estimating the effective tax rate for the year should be used even where, for example, an entity's result in the current interim period of the year is expected to be wholly offset by its result in the future interim periods of the year. The consequence of this approach is that, conceptually, even if the overall result for the year was expected to be nil position, an effective tax rate exists still needs to be applied to the interim period. This is outlined below: (INR in lakhs)

	QE June 20X3	QE September 20X3	QE December 20X3	QE March 20X4	Year ended 20X3 to 20X4
(Loss)/ Profit before tax	(350)	850	(300)	(200)	Nil
Tax rate	30%	30%	30%	30%	30%
Tax charge/ (credit)	(105)	255	(90)	(60)	Nil

The management's contention that since the net income for the year will be zero no income tax expense shall be charged quarterly in the interim financial report, is not correct. Here the effective tax rate would be 30% as it will lead to Nil tax charge. Therefore, income tax expense will be recognized in each interim quarter based on this rate only. Accordingly tax change for quarter ended 30th September would be INR 255 lakh.

8. An overview of the competitive forces in the industry is as follows:

1. **Threat of New Entrants:** While it is possible for small fashion designers to enter the market, new entrants face challenges in finding a sufficient number of retailers willing to sell their products, and their designs must appeal to fashion-conscious customers. There may be a greater threat from small fashion designers and

manufacturers who are trying to grow their businesses rather than from entirely new entrants.

2. **Bargaining Power of Customers:** Customers are either the end consumers or department stores. The number of wholesale outlets has been falling, suggesting that department stores are switching to competitors, which may give department stores a reasonable amount of bargaining power over Becky Bond. For own store sales and e-shopping, customers will only buy the company's goods if they are attracted by the design and the price, giving customers some bargaining power.

3. **Bargaining Power of Suppliers:** Becky Bond's suppliers are mainly small manufacturing firms in Nagpur and Thane. These suppliers may not have strong bargaining power, except that rising manufacturing costs mean they are demanding higher prices for their goods.

4. **Threat of Substitutes:** There are probably no direct substitutes for fashion clothes, although customers may be able to switch to cheaper fashion goods retailers. There is insufficient information to assess the strength of this force in the industry definitively.

5. **Rivalry Among Existing Competitors:** Competition between fashion goods producers seems to be strong, although the intensity may vary between different parts of the world. In Mumbai, the main competition comes from 'Gen Z', 'Caterpillar', and 'Beat It'. These competitors may compete as much on fashion design as on price. It seems probable that competition between firms keeps prices lower than they might otherwise be.

Assessing competitive environment, Becky Bond can develop strategies to strengthen its competitive position within the fashion industry.

9. The **main supply chain** for Becky Bond is relatively short, starting with producers of materials for fashion clothes. These materials are purchased by businesses that manufacture the clothing for Becky Bond. The manufacturers are mainly small independent firms in Nagpur and Thane, although the company has its own small manufacturing subsidiary near Pune, which produces less than 5% of its total annual requirements. The manufactured goods are transported to the company's distribution centre in Pune. Becky Bond buys the manufactured clothes that it has designed and distributes them to retailers directly from Pune. Retailers may be department stores or its own stores. There are also some e-sales direct to customers.

However, there are **some weaknesses** in the supply chain. Most sales are in Mumbai, but most manufacturing is in Nagpur and Thane. Although these areas may be cheaper for manufacturing, the costs of transporting the clothes to the distribution centre in Pune may be quite high. Additionally, there is no information about the efficiency of Becky Bond's delivery system, but ***operating with two distribution centres*** may be inefficient and slow down the transfer of manufactured goods to stores. Its competitor, 'Gen Z', has a manufacturing centre in Mumbai and a modern distribution system, which gives 'Gen Z' a strategic advantage because of lower transport costs and quicker distribution. 'Gen Z' operates a just-in-time system for ordering goods from manufacturers, and this seems to be more successful than Becky Bond's attempts to do the same thing.

Furthermore, ***reliance on numerous small suppliers has led to longer lead times*** and recent disputes over price increases. The supply chain operates slowly between Becky Bond and its manufacturers, putting the company at a disadvantage compared with 'Gen Z' and 'Caterpillar'. The just-in-time (JIT) system has only been partially successful due to long lead times from small manufacturers to the central distribution centre. ***Department stores' tendency to place supplementary orders late*** in the season complicates inventory management and distribution planning.

To overcome these supply chain weaknesses, Becky Bond can implement several strategies. ***Forming strategic partnerships*** with key suppliers can ensure more consistent pricing and supply, possibly involving longer-term contracts or volume commitments. ***Reducing the number of suppliers*** to a manageable few who can offer better terms for larger orders can help negotiate lower prices and improve lead times. Improving the just-in-time system by collaborating closely with suppliers to shorten lead times and increase responsiveness to market demands is essential. ***Maintaining a strategic inventory buffer*** for fast-moving items can quickly fulfil supplementary orders from department stores without significant delays. ***Streamlining operations*** to reduce costs, possibly by consolidating manufacturing processes and improving logistics, will be beneficial. Lastly, ***investing in technology*** to enhance supply chain visibility and efficiency, from design and manufacturing to distribution and sales, can significantly improve overall performance.

CASE STUDY 5

Luminous Ltd. is a company engaged in the manufacture of solar panels. The vision of the company is to provide the most compelling value in solar energy industry. By value, the company means designing and installing highest quality solar panels on a timely basis with proper safety standards and lowest cost. The company aims at providing the country with clean, abundant, low cost, distributed and renewable energy. It is one of the largest vertically integrated solar company that offers services across the spectrum of photovoltaics manufacturing. The company offers and produces high efficiency solar panels with higher performance and enhanced reliability. The company has the following vision:

"To be world class leader in businesses that contribute to nations in building infrastructure through sustainable value creation".

Luminous Ltd. has always been a standard for all the manufacturing companies for product quality. The company has multiple quality checks during its solar module production. This helps to ensure flawless production of solar panels and hence attain utmost customer satisfaction.

The company believes that in resource-scarce developing countries, identifying and targeting R&D policies in critical areas, such as energy, is particularly important to maximize benefits derived from limited funds and skilled manpower. Energy R&D policy analysis and formulation in a developing country should not be carried out in isolation — it must be consistent with overall technology policy, as well as national energy policy. The management of the company is of the view that ultimately, energy R&D policies and priorities must support the goals of national socioeconomic development. Therefore, these priorities must be determined on the basis of an analytical framework that recognizes and addresses national development objectives. The company's Research & Development department is working very hard to come out with solar panels with the lowest possible cost, so as to compete with the foreign manufacturers of solar panels. During the FY 2023-24, the Government gave the following grants to Luminous Ltd. for its business of solar panel:

1. ₹ 30 lakhs for past research of technology related to solar system. There is no condition attached to the grant.
2. ₹ 5 lakhs towards purchase of machinery of ₹ 15 lakhs. Useful life of the machinery is 5 years and depreciation on the machinery is to be charged on straight line basis.

3. 3 acres of land to set up a plant. The fair value of the land is ₹ 20 lakhs.

4. Government grant of ₹ 20 lakhs to defray expenses for environmental protection. Expected environmental costs to be incurred is ₹ 6 lakhs per annum for the next 5 years.

B R Sridharan & Associates are statutory auditors of company for FY 2023-24. The said chartered accountant firm has a robust team of skilled and proficient Chartered Accountants, who can handle all financial services areas relating to accounting, auditing and assurance, income tax, GST, company law matters, foreign exchange matters, etc.

During the financial year under consideration, the Board of Directors of the company passed a board resolution to sell one of the company's undertakings out of the multiple undertakings of the company. One of the directors of the company, Mr. Ramesh, is of the view that the board can exercise this power with the consent of shareholders by way of an ordinary resolution and passing only a Board resolution would not be sufficient. The other directors on the Board, however, did not agree with him. The investment of the company in the said undertaking which has been proposed to sell is 22% of its net worth as per the last audited balance sheet of F.Y. 2022-23.

Further, Mr. Ramesh stays in Delhi with his wife. With respect to one of his immovable house properties in USA, he took the professional services of a consulting engineer, Mr. George, based in Chennai. Mr. George has high engineering qualifications, specialised background and wide experience and can plan, design and supervise and help in undertaking maintenance of any type of structure according to the needs of the client.

On 31.05.2023, Mr. Ramesh took his family to an amusement park located in Gurugram (Haryana). This particular amusement park has various attractions such as rides and games as well as other events for entertainment purposes. For such visit, son of Mr. Ramesh who stays in Jaipur for his studies came to Delhi. Mr. Ramesh bought three tickets for the amusement park.

Luminous Limited is based in Delhi, primarily. During the FY 2023-24, the company receives legal services from an attorney in Dubai (unrelated person) in relation to registration of company's trademark in Dubai. The company paid AED 10,000 for the same to the attorney in Dubai.

The company has 10 directors on its board. Three of the directors have retired by rotation at the Annual General Meeting conducted recently. The place of retiring directors is not so filled up and the meeting has also not expressly resolved 'not to fill the vacancy'. Since the AGM

could not complete the said business, it was adjourned to the same day in the next week, at the same time and place. At this adjourned meeting also, the place of retiring directors could not be filled up, and the meeting has also not expressly resolved 'not to fill the vacancy'.

Further, Mr. Baldev is one of the independent directors of the company. During the financial year under consideration, the company paid him the sitting fees amounting to ₹ 35,000, for the month of December.

The company has its retail showrooms in Patiala and Delhi and factory at Ludhiana. During the F.Y. 2023-24, the company has manufactured 1,50,000 units of solar panels at its factory at Ludhiana, Punjab. The management decided to transfer half of the units manufactured to one of its retail showrooms in Patiala and the second half to its retail showroom in Delhi for sale therefrom. The factory and the aforesaid retail showrooms are registered under GST, in the states where they are located. Further, the company has obtained separate registrations under GST, for Ludhiana factory and the Patiala showroom. The management of the company understands that such transfer shall not be considered as supply under GST as such transfers are without any consideration.

I. Multiple Choice Questions

1. Is understanding of Mr. Ramesh for obtaining prior consent for selling one of the undertakings of the company, correct, considering the fact that Luminous Limited is not a private company?

   (a) No, as only board's resolution is required in this case, which has been duly passed.

   (b) No, as the Board can exercise this power with the consent of the shareholders by a special resolution and not on its own simply by passing of an ordinary resolution.

   (c) Yes, his understanding is correct.

   (d) Partly correct, as the Board shall exercise the powers with the consent of the company by an ordinary resolution and not only by passing a Board resolution at a Board meeting. Further, prior approval of the Registrar of Companies is also required.

2. What is the place of supply with respect to the professional service rendered by Mr. George to Mr. Ramesh?

   (a) Chennai

   (b) Delhi

   (c) USA

   (d) Either Chennai or Delhi

3. What is the place of supply with respect to the tickets bought by Mr. Ramesh for the amusement park?

   (a) Delhi

   (b) Gurugram

   (c) With respect to tickets purchased for Mr. Ramesh and his wife, the place of supply is Delhi and for the ticket purchased for his son, the place of supply is Jaipur.

   (d) Either Delhi or Gurugram

4. Which of the following is the correct statement with respect to the GST liability in case of the fees paid to Mr. Baldev?

   (a) GST shall be payable by Luminous Ltd. under reverse charge mechanism.

   (b) GST shall be payable by Mr. Baldev.

   (c) Sitting fees paid to the director of a company is exempt under GST.

   (d) Sitting fees paid to the director of a company is treated as salary paid to the director and is not chargeable to GST and is subject to deduction of TDS under section 192 of the Income Tax Act, 1961.

5. Mr. Baldev has got sitting fees amounting to ₹ 35,000 in the capacity of director of company for month of December. Which of following statements is most appropriate in this regard?

   (a) Such an income is taxable in hands of Mr. Baldev under the head “Income from other Sources”. The company should deduct tax at source @ 1% while making such payment.

(b) Such an income is taxable in hands of Mr. Baldev under the head "Salaries". The company should deduct tax at source at rates in force applicable to salaried individual while making such payment.

(c) Such an income is taxable in hands of Mr. Baldev under the head "Income from other Sources". The company should deduct tax at source @ 5% while making such payment.

(d) Such an income is taxable in hands of Mr. Baldev under the head "Income from other Sources". The company should deduct tax at source @ 10% while making such payment.

II. Descriptive Questions

6. (i) Whether the retiring directors shall be deemed to have been re-appointed at the adjourned meeting?

(ii) What will be your answer in case at the adjourned meeting, the resolutions for re-appointment of these directors were lost?

(iii) Whether such directors can continue in case the directors do not call the Annual General Meeting?

7. Whether the management's understanding related to the transfer of solar panel to the company's retail showrooms, correct, in view of the GST law?

Also determine the place of supply in case of services procured from attorney by Luminous Limited and suggest if the company is required to pay tax under reverse charge on such transaction.

8. How should Luminous Ltd. recognise the government grants in its books of accounts for the F.Y. 2023-24?

ANSWERS TO THE CASE STUDY 5

I. Answers to the Multiple Choice Questions

1. (b) No, as the Board can exercise this power with the consent of the shareholders by a special resolution and not on its own simply by passing of an ordinary resolution.

Reason: The powers of the Board of Directors of a company are not unrestricted or uncontrollable as Section 180 of the Companies Act 2013 portrays. This Section contains directive provisions which direct that the powers in respect of specified matters shall be exercised by the Board subject to the certain restrictions i.e. in such cases the exercise of powers by the Board shall be restricted as per law. Section 180 is not applicable to a private company.

(i) Matters in respect of which powers shall be exercised after obtaining consent by a special resolution: According to Section 180 (1), following are the matters in respect of which the Board shall exercise the powers with the consent of the company by a special resolution and not on its own simply by passing a Board resolution at a Board meeting:

(a) To sell, lease or otherwise dispose of the whole or substantially the whole of the undertaking of the company or where the company owns more than one undertaking, of the whole or substantially the whole of any of such undertakings. In other words, out of multiple undertakings of a company even if one is sold, leased or disposed of, either wholly or substantially, the consent by special resolution shall be required.

2. (b) Delhi

Reason: Section 12(3) of the IGST Act, 2017 provides that the place of supply of services,—

(a) directly in relation to an immovable property, including services provided by architects, interior decorators, surveyors, engineers and other related experts or estate agents, any service provided by way of grant of rights to use immovable property or for carrying out or co-ordination of construction work; or

(b) by way of lodging accommodation by a hotel, inn, guest house, home stay, club or campsite, by whatever name called, and including a house boat or any other vessel; or

(c) by way of accommodation in any immovable property for organising any marriage or reception or matters related thereto, official, social, cultural, religious or business function including services provided in relation to such function at such property; or

(d) any services ancillary to the services referred to in clauses (a), (b) and (c),

shall be the location at which the immovable property or boat or vessel, as the case may be, is located or intended to be located:

Provided that if the location of the immovable property or boat or vessel is located or intended to be located outside India, the place of supply shall be the location of the recipient.

3. (b) Gurugram

Reason: Section 12(6) of the IGST Act, 2017 provides that the place of supply of following services-

(i) services provided by way of admission to following types of events: cultural, scientific, sporting, artistic, entertainment.

(ii) services provided by way of admission to amusement park or any other place.

(iii) services ancillary to the above-mentioned services.

is the place where the event is actually held or where the park or such other place is located.

4. (a) GST shall be payable by Luminous Ltd. under reverse charge mechanism.

Reason: Sitting fee paid to director – As per reverse charge notification, tax on services supplied by a director of a company/ body corporate to the said company/ body corporate, located in the taxable territory, is payable under reverse charge. Hence, in the present case, the sitting fee amounting to ₹ 35,000, payable to Mr. Baldev by Luminous Ltd., is liable to GST under reverse charge and thus, recipient of service – Luminous Ltd. – is liable to pay GST on the same.

5. (d) Such an income is taxable in hands of Mr. Baldev under the head "Income from other Sources". The company should deduct tax at source @ 10% while making such payment.

Reason: Director's sitting fees are not in nature of salary. Such income is taxable under head "Income from other Sources". Further, company should deduct tax at source on such fees @ 10% in accordance with provisions of section 194J of Income Tax Act, 1961.

II. Answers to the Descriptive Questions

6. **In accordance with the provision of the Companies Act, 2013, as contained in section 152(7)(a)** which provides that if at the annual general meeting at which a director retires and the vacancy is not so filled up and the meeting has not expressly resolved not to fill the vacancy, the meeting shall stand adjourned to same day in the next week, at the same time and place, or if that day is a national holiday, till the next succeeding day which is not a holiday, at the same time and place.

Section 152(7)(b) further provides that if at the adjourned meeting also, the place of the retiring director is not filled up and that meeting also has not expressly resolved not to fill the vacancy, the retiring director shall be deemed to have been re-appointed at the adjourned meeting, unless at the adjourned meeting or at the previous meeting a resolution for the re-appointment of such director was put and lost or he has given a notice in writing addressed to the company or the Board of Directors expressing his desire not to be re-elected or he is disqualified.

Therefore, in the given circumstances answers to the asked questions shall be as under:

(i) In the first case, applying the above provisions, the retiring directors shall be deemed to have been re-appointed.

(ii) In the second case, where the resolutions for the reappointment of the retiring directors were lost, the retiring directors shall not be deemed to have been re-appointed.

(iii) Section 152(6)(c) states that 1/3rd of the rotational directors shall retire at every AGM.

Accordingly, the directors will retire as soon as the AGM is held on its due date. Further, as per Section 96 (dealing with Annual General Meeting), every company other than a One Person Company is required to hold an Annual General Meeting each year. Hence, it is necessary for the company to hold the AGM, where the directors liable to retire by rotation shall retire. In case AGM is not held till the last date on which it should have been held, the term of retiring directors ends on this last date and it cannot be extended till the new date when the AGM shall be held. As the calling of the AGM is the duty and responsibility of the directors, they by omitting to call the AGM on its due date cannot take advantage of their own fault and by that means cannot extend their own continuance in the office for any period of their choice and as long as the holding of the next AGM does not take place.

7. **Stock transfers or branch transfers qualify as supply:** It is a common practice in business that one branch supplies services to another branch of same entity without

consideration. Similarly, goods are transferred among different units of same entity free of cost, for instance, distribution of samples manufactured in a factory to different branches or transfer of goods from factory to depot/showroom for sale therefrom, from one warehouse to another warehouse, from one branch to another branch where the demand of the goods is higher. These transactions are termed as self-supplies.

Under GST, these transactions undertaken, even without consideration, will also qualify as supply, provided the transfer of goods or services is between

(i) different locations (with separate GST registrations) of same legal entity as these are transactions between distinct persons, or

(ii) establishments of distinct persons.

The establishments of a person with **separate registrations** whether within the same State/UT or in different States/UTs are considered as distinct persons as per section 25(4) of the CGST Act, 2017.

Therefore, transfer of solar panels from Ludhiana factory to showroom in Delhi will be considered as a supply under GST.

Also, since the company has obtained separate registrations for the Ludhiana factory and the showroom in Patiala, the transfer of solar panels will also constitute supply.

Service of Attorney taken by Luminous Limited:

In the given case, the service provider i.e. the attorney, is outside India, and the service recipient i.e. Luminous Limited, is based in Delhi, India. Thus, the place of supply will be determined on the basis of the provisions of section 13 of the IGST Act, 2017. Since the given service does not get covered under any of the specific provisions of section 13 of the IGST Act, 2017., the place of supply thereof will be governed by the general rule, i.e. place of supply of services will be the location of the recipient of service, which in this case is Delhi (India).

Further, the given case is import of service in terms of section 2(11) of the IGST Act, 2017 as the supplier of service is located outside India, the recipient of service is located in India and the place of supply of service is in India. Since the services are imported for a consideration from an unrelated person, the same tantamount to supply in terms of section 7(1)(b) of CGST Act, 2017 and are liable to GST.

As per reverse charge *Notification No. 10/2017 Integrated tax(R) dated 28.06.2017*, if a service is supplied by a person located in a non-taxable territory to a person located in the taxable territory, other than non-taxable online recipient, the tax is payable by the

recipient of service under reverse charge. Therefore, Luminous Limited will pay GST under reverse charge on AED 10000 paid by it to the attorney in Dubai.

8. Luminous Ltd. should recognise the government grants in its books of accounts in the following manner:

1. Entire grant amount of ₹ 30 lakhs should be recognised immediately in the profit & Loss account as there are no conditions attached to the grant.

2. ₹ 5 lakhs should be recognised as deferred income and will be transferred to profit and loss over the useful life of the asset. In this case, ₹ 1,00,000 [₹ 5 lakhs/5] should be credited to profit and loss each year over period of 5 years.

   Alternatively, ₹ 5,00,000 may be deducted from the cost of the asset and depreciation shall be charged at ₹ 10,00,000 (₹ 15,00,000 – ₹ 5,00,000).

3. Land should be recognised at fair value of ₹ 20 lakhs and government grants should be presented in the balance sheet by setting up the grant as deferred income. Alternatively, deduct the amount of grant from the cost of the asset. In the given case, the land is granted at no cost. It will be presented in the books at nominal value.

4. As per paragraph 29 of Ind AS 20, Grants related to income are presented as part of profit or loss, either separately or under a general heading such as 'Other income'; alternatively, they are deducted in reporting the related expense.

In accordance with the above, presentation of grants related to income under both the methods are as follows:

Method 1: Credit in the statement of profit and loss: The entity can recognise the grant as income on a straight line basis i.e., ₹ 4,00,000 per year (₹ 20 lakhs / 5) in the statement of profit and loss either separately or under the head "Other Income".

Method 2: As a deduction in reporting the related expense:

Since the grant relates to environmental expenses incurred/to be incurred by the entity, it can present the grant by reducing the grant amount every year from the related expense i.e., environmental expense of ₹ 2,00,000 (i.e., net expense ₹ 6,00,000 – ₹ 4,00,000).

The Standard regards both the methods as acceptable for the presentation of grants related to income. However, method 2 may be more appropriate when the company can relate the grant to a specific expenditure. The Standard also provides that disclosure of the grant may be necessary for a proper understanding of the financial statements. Disclosure of the effect of the grants on any item of income or expense which is required to be separately disclosed is usually appropriate.

CASE STUDY 6

Economic Survey for 2023-24 has been presented to the Parliament. According to the survey, "the Indian Economy, however, appears to have moved on after its encounter with the pandemic, staging a full recovery ahead of many nations and positioning itself to ascend to the pre-pandemic growth path". It is also stated that agencies worldwide continue to project India as the fastest growing major economy.

This could be possible with TEAM (Together Everyone Achieves More) efforts. The participants of this Team are the Central Government, State Governments, industry and the people of this country.

There has been a tectonic shift in policies of the government. The emphasis of the present government has been to stimulate entrepreneurship so that more and more people become job givers rather than job seekers. This has also resulted in providing impetus and encouragement to the youth of the nation to pursue their entrepreneurial dreams.

One such case of entrepreneurial dreams is of Manu and Tanu, two friends who always aspired to have their own business ventures when they complete their education. They both completed MBA from top business schools in India and were working in large corporates with big pay packages.

Whilst they always wanted to pursue business ideas, nothing came their way which enticed them to start their entrepreneurial journey. Meanwhile, Manu who was interested in economic policy and defence related matters came across a write up which described the shift in the policy by the present government in defence sector. The new policy emphasised on giving priority to the indigenous market players and reserving more than 500 items for domestic manufacturing, was a lucrative business chance, he thought.

Though Manu and Tanu were in contact, it had been couple of years since they met. Manu met Tanu and discussed this idea of business potential in defence sector and how they could start something of their own. They believed there is a lot of scope in domestic as well as in global market, if they could manufacture the ancillary items used in defence equipment.

Having realised their true calling, both resigned from their high paying jobs to start their own venture. In 2021, they incorporated a company called M&A Private Ltd, with both of them being

the shareholders and directors of the Company. Gradually, when the business started growing, they brought in Shyam as a shareholder and director. Presently, Shyam holds 12% of the equity share capital while Manu and Tanu hold 44% each. The Company is able to fund its operations internally without seeking any outside funds.

As both Tanu and Manu had business acumen and strategic vision, they wanted to rely on a professional who can guide them on accounting, law and compliance matters and give expert advice at various points in time as required by business. They appointed their long-time friend and a tenured financial professional, Ajim as the Chief Financial Officer (CFO) of the Company.

During one of the board meetings, while briefing about the audit status, the CFO informed the directors that the financial statements for the current year would be prepared as per the Indian Accounting Standards (Ind AS). In the audit kick-off meeting held in March 2024, the following points were discussed by the CFO, while Tanu and Manu, added their insights:

(A) Shyam is a director on the Board of Directors and holds 12% equity shares of the Company. As Shyam had some financial emergency, Tanu and Manu wanted to support him by giving loan of ₹ 5 Lakhs from the Company. CFO mentioned that the Company had an accumulated profit of ₹ 7.5 Lakhs as on the date of loan to Shyam. It is pertinent to note that Shyam is also a Partner in Shyamlal & Co, with a 30% profit sharing therein. During the current year, the Company made an advance of ₹ 2 Lakhs to Shyamlal & Co. towards procurement of materials.

(B) The Company also purchases goods from entities registered under Micro, Small and Medium Enterprises Act, 2006. The CFO of the Company provides the following information of trade payable to Micro and Small Enterprises:

Not due	₹ 7 lakhs (out of which ₹ 3 lakhs are disputed)
Due less than 1 year	₹ 12 lakhs (out of which ₹ 2 lakhs are disputed and in arbitration)
1-2 years	₹ 3 lakhs disputed
More than 2 years	Nil

During the year, the Company paid an interest of ₹ 2.50 lakhs in terms of section 16 of the Micro, Small and Medium Enterprises Development Act, 2006 and ₹ 1.5 Lakhs were paid beyond the appointed day and the interest due of ₹ 10,000 was not paid.

(C) M&A Private Ltd acquired 100% of the shares of another company P&T Private Ltd. The negotiations for this acquisition commenced on 1st January 2023 and the agreement was finalised on 1st March 2023. While M&A Private Ltd obtained the power to control P&T Private Ltd.'s operations on 1st March 2023, the agreement states that the acquisition is effective from 1st January 2023 and that M&A Private Ltd is entitled to all profits after that date. In addition, the purchase price is based on P&T Private Ltd.'s net assets as at 1st January 2023. The final settlement of consideration was made on 1st May 2023.

(D) M&A Private Ltd also holds 70% stake of issued equity share capital of SAGE Ltd. and 45% of issued redeemable preference shares. This acquisition was made on 31st December 2023. Issued and paid-up equity and preference share capital of SAGE Ltd as on 31st March 2023 is ₹ 15 Crores and ₹ 5 Crores respectively. Balance in the Statement of Profit and Loss for the year ended 31st March 2024 is ₹ 25 Crores. All the book values of assets and liabilities were same as their fair values except for an item of Property, Plant and Equipment (PPE). The carrying amount, at the time of acquisition by M&A Private Ltd, of PPE is ₹ 3 crores and its fair value was ₹ 6.20 Crores. No adjustment for fair-value has been done in the books of SAGE Ltd.

(E) Anu is also a director of M&A Private Ltd, who was going on world tour for a period of 5 months. In his absence, he wishes to appoint his friend Kumar, as an alternate director of M&A Private Ltd on his behalf. The Articles of Association of the Company allows the appointment of alternate director.

(F) M&A Private Ltd enters into a seven-year service contract with a customer NP Ltd for an amount of ₹ 21 Lakhs i.e. ₹ 3 Lakhs per year. The standalone selling price for one year contract at inception of the contract is ₹ 3 Lakhs per year. M&A Private Ltd. accounts for the contract as a series of distinct services. At the beginning of the Seventh year, the parties agree to modify the contract as follows:

- the fees for the seventh year is reduced to ₹ 2.7 Lakhs and
- NP Ltd agrees to extend the contract for another seven years for ₹ 16.80 Lakhs i.e. ₹ 2.40 Lakhs per year.

The standalone selling price for one year of service at the time of modification is ₹2.10 Lakhs.

I. Multiple Choice Questions

1. The CFO says that the tax auditor wants to treat the loan of ₹ 5 Lakhs to Shyam and advance of ₹ 2 Lakhs to Shyamlal & Co. as deemed dividend. Is it appropriate?

   (a) Both the loan of ₹ 5 Lakhs and advance of ₹ 2 Lakhs will not be treated as deemed dividend as both are repayable.

   (b) The loan of ₹ 5 Lakhs and advance of ₹ 2 Lakhs will be treated as deemed dividend only to the extent of ₹ 90,000 i.e. 12% of the accumulated profit.

   (c) Both the loan and advance will not be treated as deemed dividend as his interest in the Company is only 12%.

   (d) The loan will be taxable as deemed dividend, but the advance given to Shyamlal & Co. will not be treated as deemed dividend since it is a business advance.

2. CFO states that the interest paid to the MSME vendors is allowed as a business expenditure and should be reported accordingly in the tax returns:

   (a) The interest of ₹ 2.60 Lakhs will be deductible, as it is business expenditure.

   (b) The interest of ₹ 1.95 Lakhs will be deductible, as 75% of the interest paid to MSME vendors will be allowed as a deduction.

   (c) The interest of ₹ 2.50 Lakhs paid to MSME vendors will not be allowed as deduction from computation of income, as the Micro, Small and Medium Enterprises Act, 2006 specifically prohibits such deduction.

   (d) The interest of ₹ 1.25 Lakhs will be deductible, as 50% of the interest paid to MSME will be allowed as a deduction.

3. As per Ind AS 103, what is the date of acquisition of P&T Private Ltd. by M&A Private Ltd. for the purposes of business combination?

   (a) 1st January 2023

   (b) 1st March 2023

   (c) Either of 1st January 2023 or 1st March 2023 at the choice of M & A Private Ltd.

   (d) 1st May 2023

4. Compute the amount of non-controlling interest of SAGE Ltd as on 31st March 2023:

   (a) ₹ 15.68 Crores

   (b) ₹ 12.00 Crores

   (c) ₹12.96 Crores

   (d) ₹ 14.75 Crores

5. Whether Anu has a right to appoint alternate director in his absence:

   (a) Claim made by Anu to appoint Kumar as alternate Director is valid, as the Articles of Association of M&A Private Ltd provide for appointment.

   (b) Claim made by Anu to appoint Kumar as alternate Director is not valid, as the authority to appoint alternate Director vests with the Board of Directors only and that too subject to Articles of Association.

   (c) Kumar cannot be appointed as alternate director in place of Anu, since his absence will be of less than six months.

   (d) Kumar cannot be appointed as alternate director in place of Anu, since his absence will be more than 3 months.

II. Descriptive Questions

6. As Tanu and Manu are not well versed with Ind AS, with reference to business combinations, they want to understand about:

   (i) Determination of acquisition date

   (ii) Ascertainment of control

7. The CFO believes that a loan to directors is prohibited under the Companies Act, 2013. Can M&A Private Ltd extend the proposed loan to Shyam? Comment.

8. The CFO wants to understand, how to record revenue at the end of seventh year as per Ind AS 115. Also, prepare a brief note explaining the accounting for revenue when the contract is modified.

ANSWERS TO THE CASE STUDY 6

I. Answers to the Multiple Choice Questions

1. (d) The loan will be taxable as deemed dividend, but the advance given to Shyamlal & Co. will not be treated as deemed dividend since it is a business advance.

Reason: As per Section 2(22)(e) of the Income-tax Act, 1961, dividend includes - any payment by a company, not being a company in which the public are substantially interested, of any sum (whether as representing a part of the assets of the company or otherwise) made after the 31st day of May, 1987, by way of advance or loan to a shareholder, being a person who is the beneficial owner of shares (not being shares entitled to a fixed rate of dividend whether with or without a right to participate in profits) holding not less than ten per cent of the voting power, or to any concern in which such shareholder is a member or a partner and in which he has a substantial interest (hereafter in this clause referred to as the said concern) or any payment by any such company on behalf, or for the individual benefit, of any such shareholder, to the extent to which the company in either case possesses accumulated profits.

Hence, loan to director will be treated as deemed dividend and advance to firm will not be considered as deemed dividend, as it is a business advance.

2. (c) The interest of ₹ 2.50 Lakhs paid to MSME vendors will not be allowed as deduction from computation of income, as the Micro, Small and Medium Enterprises Act, 2006 specifically prohibits such deduction.

Reason: Section 23 of the MSMED Act lays down that an interest payable or paid by the buyer, under or in accordance with the provisions of this Act, shall not for the purposes of the computation of income under the Income-tax Act,1961 be allowed as a deduction

3. (b) 1st March 2023

Reason: Paragraph 8 of Ind AS 103 provides that acquisition date is the date on which the acquirer obtains control of the acquiree.

4. (a) ₹ 15.68 Crores

Share Capital	₹ in crores	NCI	₹ in crores
Equity	15	30%	4.5
Preference	5	55%	2.75
Profit	25	30%	7.5
Fair Value Adjustment	3.2	30%	0.96
Depreciation Adj	0.1	30%	-0.03
			15.68

5. (b) Claim made by Anu to appoint Kumar as alternate Director is not valid, as the authority to appoint alternate Director vests with the Board of Directors only and that too subject to Articles of Association.

Reason: Section 161 of the Companies Act, 2013 vests the Board of Directors to appoint any person as an alternate director and not to the director during whose absence he is to act.

II. Answers to the Descriptive Questions

6. (i) **Determination of Acquisition Date: Paragraph 8 of Ind AS 103 provides the acquisition date as the date on which the acquirer obtains control of the acquiree. Further, Paragraph 9 of Ind AS 103,** clarifies that the date on which the acquirer obtains the control of the acquiree is generally the date on which the acquirer legally transfers the consideration, acquires the assets and assumes the liabilities of the acquiree — the closing date.

However, the acquirer might obtain control on a date that is either earlier or later than the closing date. For example, the acquisition date precedes the closing date if a written agreement provides that the acquirer obtains control of the acquiree on a date before the closing date.

The acquisition date is a very important step in the accounting of business combination because it determines when the acquirer recognizes and measures the consideration, the assets acquired and liabilities assumed. The acquiree's results are consolidated from this date. **The acquisition date materially impacts the overall acquisition accounting, including post-combination earnings.**

(ii) Ascertainment of Control:

Paragraphs 6 of Ind AS 110, "Consolidated Financial Statements", , states that an investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Further, para 7 of Ind AS 110 states that an investor controls an investee if and only if the investor has all the following:

(a) power over the investee;

(b) exposure, or rights, to variable returns from its involvement with the investee; and

(c) the ability to use its power over the investee to affect the amount of the investor's returns.

7. **Section 185** of the Companies Act, 2013 (the Act) imposes restrictions on the Company on providing of loans to directors of the Company. As per the exemption notified by the Ministry of Corporate Affairs, (MCA), Section 185 of the Act shall not apply to a Private Company in case of fulfillment of the following conditions:

(a) in whose share capital no other body corporate has invested any money;

(b) if the borrowings of such a company from banks or financial institutions or anybody corporate is less than twice of its paid-up share capital or fifty crore rupees, whichever is lower; and

(c) such a Company has no default in repayment of such borrowings subsisting at the time of making transactions under this section.

Analysis and Conclusion

In the given case, since the Company (M&A Private Limited) is in compliance with the above mentioned criteria. So it will be exempted from the applicability of Section 185 of the Act on it. So the restrictions marked on providing of loan under Section 185 of the Act will not be applicable on M&A Private Limited. **Hence, M&A Private Limited can extend the proposed loan to Shyam.**

8. (i) Recording of revenue at the end of the seventh year as per Ind AS 115

In the given case, even though the remaining services to be provided are distinct, the modification should not be accounted for as a separate contract because the price of the contract did not increase by an amount of consideration that reflects the standalone selling price of the additional services.

The modification would be accounted for, from the date of the modification, as if the existing arrangement was terminated and a new contract created (i.e. on a prospective basis) because the remaining services to be provided are distinct.

M&A Pvt. Ltd. should reallocate the remaining consideration to all of the remaining services to be provided (i.e. the obligations remaining from the original contract and the new obligations). M&A Pvt. Ltd. will recognize a total of ₹ 19.50 lakhs (₹ 2.70 lakhs + ₹ 16.80 lakhs) over the remaining eight-year service period (one year remaining under the original contract plus seven additional years) or ₹ 2.4375 lakhs per year.

(ii) Brief note for accounting for revenue when the contract is modified:

Paragraphs 18 to 20 of Ind AS 115 deals with contract modification. It provides in certain circumstances to treat it as a separate contract. A contract modification is a change in the scope or price of the contract that is approved by the parties to the contract.

A contract modification is a change in the scope or price (or both) of a contract i.e. approved by the parties to the contract. The contract modification exists when parties to a contract approves a modification that either creates a new or changes existing enforceable rights and obligations of the parties to the contract. A contract modification could be approved in writing, by oral agreement or implied by customary business practices. If the parties to the contract had not approved to the contract modification, the entity shall continue to apply this standard to the existing contract until the contract modification is approved.

Accounting for the modification

Once determination of contract being modified is established, the entity further determines its accounting either as a separate contract or as a termination of the

old contract and the creation of a new contract, by making a cumulative catch-up adjustment to the original contract or a combination of the two.

An entity accounts for a contract modification as a separate contract if the modification

(1) increases the scope of the work promised under the original contract by adding new promised goods or services that are considered distinct, **and**

(2) the increase in the contract price reflects the stand-alone selling price of the additional goods or services.

If a modification adds a distinct good or service to a series of distinct goods or services that is accounted for as a single performance obligation, the modification is accounted for as a separate contract as long as the transaction price increases by the stand-alone selling price for those added goods or services.

CASE STUDY 7

The Connect Group, one of India's largest conglomerates, was founded by Ramlal Jain in 1966. Initially starting as a small textile company named Connect Commercial Corporation, it rapidly expanded its operations into diverse sectors such as petrochemicals, refining, oil, telecommunications, retail, and infrastructure.

Ramlal Jain's visionary leadership and innovative business strategies transformed the company into a significant player in the Indian economy. Following his passing in 2002, the group was divided between his sons, Vansh Jain and Suhaan Jain, leading to the formation of Connect Industries under Suhaan Jain and Connect Group under Vansh Jain, each continuing to grow and diversify their respective business interests.

The Connect Group is among India's top private sector business houses serving over 250 million customers across telecommunications, power, financial services, infrastructure, media and entertainment, and healthcare sectors. The Connect Group positively influences the lives of one in every 5 aspiring Indians across more than 24,000 cities and towns and 4,20,000 villages.

The Connect Group strongly believes that it has a pivotal role to play in shaping the destiny of the nation. Through its various consumer-facing businesses, the Group provides a robust platform to every Indian to realize his/ her potential through its state-of-the-art products and services. The Group enjoys the unparalleled trust, faith and confidence of its customers, and is one of the largest employers in the country with a young, highly-trained and motivated workforce, with an average age of 35 years.

The vision of the group is **"To build a global enterprise, and a great future for country, to give millions of talents the power to shape their destiny"**

One of the Connect Group company, Connect India Ltd. (CI) entered the Indian telecommunications landscape in 2002. Leveraging its substantial resources, CI embarked on an ambitious journey to revolutionize connectivity in India. By rapidly expanding its network infrastructure and introducing both GSM and CDMA services, CI aimed to bridge the digital divide and bring affordable communication solutions to every corner of the country. Positioned as a disruptor in the market, CI challenged the status quo of traditional landline communication, offering consumers a glimpse of the transformative power of mobile technology.

CI's ascent to prominence was marked by its innovative marketing strategy, which centered around bundling GSM handsets with Connect connections. This strategic move was not merely

about selling handsets; it was a bold attempt to democratize access to mobile communication. By offering affordable handsets bundled with CI's telecom services, the company effectively lowered the entry barrier for millions of potential subscribers. This approach tapped into the aspirations of a burgeoning middle class eager to embrace modern communication technologies. As consumers flocked to avail themselves of these bundled offerings, the demand for traditional landline connections witnessed a precipitous decline, signaling a strong shift in the telecommunications landscape.

CI's disruptive approach had a profound impact on its competitors in the telecommunications sector. Traditional landline providers, such as RWNL, faced significant challenges as consumers increasingly opted for CI's mobile offerings. The aggressive pricing and innovative service packages introduced by CI forced competitors to rethink their strategies and offerings. In response, competitors had to lower their tariffs, improve service quality, and explore new revenue streams to remain competitive in the evolving market. CI faced intense competition from other major telecom players like Dtel, M Phone, and IA Cellular. Despite their efforts, many competitors struggled to keep pace with CI's rapid expansion and innovation, leading to a reshuffling of market dynamics and heightened competition across the sector.

In the 2010 spectrum auction, CI secured 3G licenses for three cities with a licensing fee of ₹57 billion. By leveraging MIMO technology in 2011, CI improved the quality of its 3G service, achieving data rates up to 28 Mbit/s. In 2013, CI signed a multi-year managed services agreement (MSA) with Startel to manage services of wireline and wireless network of 1,20,000 kilometres of fiber and mobile infrastructure in 11 telecom circles in India. This arrangement was a smooth business relationship until 2016, post which CI struggled to pay the dues. This has been seen as an effect of Connect XG that disrupted the Indian telecom industry with its aggressive pricing after its commercial launch in September 2016 that affected all leading telecom players. By 2016, the company discontinued its CDMA operations, migrating subscribers to GSM and LTE networks. The same year, CI acquired Digicable, India’s largest cable network, integrating it into a new entity, Connect Digicom, to bolster its DTH TV, IPTV, and broadband services. Additionally, CI acquired Sistem Sure TeleServices Limited (SSTL), gaining SSTL’s spectrum in the 850 MHz band and its subscriber base. In September 2016, CI announced a merger with Freecel, which was expected to help repay ₹250 billion of debt. Despite approvals from regulatory bodies, the deal fell through in October 2017 due to delays and competitive pressures. The failed merger exacerbated CI’s financial distress, leading to the redundancy of employees and the discontinuation of voice services in December 2017.

CI's financial problems worsened when it couldn't pay Startel under a managed services agreement. Startel took the issue to the National Company Law Tribunal (NCLT) to recover ₹12 billion, which led to insolvency proceedings. Even though a settlement was reached, CI failed to comply, resulting in contempt of court proceedings. Suhaan Jain intervened with a bailout (financial aid) to prevent legal consequences, highlighting the importance of strategic crisis management. Auditors were very concerned about the risk of fraudulent reporting at CI because of its financial troubles. The company's struggle to meet its financial obligations might have led to a temptation to manipulate financial statements to look better than they actually were.

Despite its promising start, CI's journey was fraught with challenges that ultimately led to its decline. Intense competition from both established players and disruptive entrants, coupled with rapid technological advancements, eroded CI's market share and profitability. Additionally, the company grappled with a substantial debt burden incurred during its expansion phase. Efforts to alleviate financial pressures through strategic partnerships and merger attempts were thwarted by regulatory hurdles and internal disagreements. In May 2019, CI succumbed to its financial woes, filing for bankruptcy under the Insolvency and Bankruptcy Code. This marked a sobering end to a once-promising venture and underscored the volatile and complex nature of the telecommunications industry, where innovation and disruption often come hand in hand with uncertainty and risk. By 2020, a consortium of companies bid over $250 million for CI's assets. Ultimately, Suhaan Jain's Connect XG acquired these assets for ₹3,700 crores in 2021. This acquisition was part of XG's broader strategy to consolidate its market position and expand its telecom infrastructure. As a part of this expansion, Connect XG acquired the right to use spectrum for high frequency bands on April 1, 2020, by making an upfront payment of ₹ 1,000 crores. The spectrum was valid for a period of 20 years.

In the previous year 2023-24, the Connect XG transferred part of the spectrum for a consideration of ₹ 300 crores when 17 years of the spectrum period were still remaining. After the spectrum was sold, there was news in the industry that Moonlink Telecom was interested in buying the spectrum sold for a whopping amount of ₹ 900 crores. However, Moonlink Telecom was embroiled in a legal battle with the government over a disputed amount of ₹2,000 crores, complicating their potential acquisition.

I. Multiple Choice Questions

1. With reference to the case, which term best describes Connect XG's strategy of using aggressive pricing to enter the telecom market and target the lowest market segments? Additionally, CI's initial strategy to offer GSM handsets bundled with their telecom services was an example of which strategy:

   (a) XG's strategy - New-market disruption; CI's strategy - Low-end disruption

(b) XG's strategy - Market penetration; CI's strategy - Technological innovation

(c) XG's strategy - Low-end disruption; CI's strategy - New-market disruption

(d) XG's strategy - Technological innovation; CI's strategy - Market penetration

2. To gain competitive advantage, which approaches were most likely followed by CI?

(a) It improved the quality and speed.

(b) It focused on enhancing only their call quality.

(c) It acquired additional spectrum and subscribers.

(d) It started value package including reduced the cost of basic services.

Options:

(a) (i) & (ii)

(b) (i) & (iii)

(c) (iii) & (iv)

(d) (i), (ii) & (iv)

3. CI acquired Digicable, India's largest cable network, integrating it into a new entity, Connect Digicom, to bolster its DTH TV, IPTV, and broadband services. This is most likely an example of which type of integration?

(a) Horizontal integration

(b) Backward integration

(c) Forward integration

(d) Diversification in supply chain

4. In the context of mergers and acquisitions (M&A), which financial metric would be most relevant for assessing the potential value of CI as an acquisition target?

(a) Price-to-Earnings (P/E) Ratio

(b) Debt-to-Equity (D/E) Ratio

(c) Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA) Margin

(d) Return on Investment (ROI)

5. Considering the financial distress faced by Connect India, which risk factor should auditors prioritize during the audit engagement?

   (a) The risk of inventory obsolescence due to rapid technological advancements.

   (b) The risk of fraudulent reporting to mask financial difficulties.

   (c) The risk of non-compliance with labor laws leading to legal liabilities.

   (d) The risk of inadequate documentation of fixed asset impairments.

6. Given the provided facts, if the transaction involving Connect XG's sale of spectrum to Moonlink Telecom had occurred, comment on the legal position regarding such a transaction under the Insolvency and Bankruptcy Code (IBC), 2016

   (a) Connect XG's sale of the spectrum for ₹ 300 crores is invalid as the IBC requires that any transfer of assets must be done at fair market value, which is closer to ₹ 900 crores in this case.

   (b) Moonlink Telecom cannot purchase the spectrum because they are involved in a legal battle over a disputed amount, which under the IBC, 2016, disqualifies them from acquiring assets.

   (c) The IBC, 2016 does not have any direct provisions regarding the sale of spectrum, thus, the sale by Connect XG for ₹ 300 crore will be valid, irrespective of Moonlink Telecom's interest.

   (d) Moonlink Telecom can purchase the spectrum if they resolve their legal dispute with the government and prove their financial stability under the IBC, 2016.

II. Descriptive Questions

7. Using Porter's Five Forces framework, ANALYZE how intense competitive rivalry and the high bargaining power of buyers in the telecommunications market contributed to the decline of CI.

8. Evaluate the effectiveness of valuation techniques in the acquisition of Connect India by XG.

9. (a) Compute the deduction available to Connect XG under Income-tax Act, 1961 for the previous year 2023-24 and the amount chargeable to tax, if any, assuming that the company has been claiming deduction since the year of acquisition of the spectrum.

(b) Suppose if the part of the spectrum was sold for ₹ 900 crores as per the bid by Moonlink Telecom, then what would be the taxability under Income-tax Act, 1961.

ANSWERS TO THE CASE STUDY 7

I. Answers to the Multiple Choice Questions

(1) (c) XG's strategy - Low-end disruption; CI's strategy - New-market disruption

Reason: Low-end disruption occurs when a company uses a low-cost business model to enter at the bottom of an existing market and claim a segment. As the entrant company claims the lowest market segment i.e. a lower profit-making segment for the incumbents, the other existing companies typically retreat upmarket, means that they move further "upstream" where profit margins are higher. Therefore it creates a situation where the other players in the industry actually are motivated to flee rather than fight you.

New-market disruption occurs when a new entrant expands the market by targeting customers who have never used a similar product before. The disruptive company ***creates a new market*** by making its products more accessible or less expensive.

2. (b) (i) & (iii)

Reason: The introduction of MIMO technology by CI improved the quality and speed of their 3G services, providing a better user experience and differentiating their offerings from those of competitors who did not offer similar technology enhancements. The acquisition of SSTL provided CI with additional spectrum and subscribers, strengthening its market position and expanding its service capabilities, thereby contributing to its competitive advantage.

3. (a) Horizontal integration

In this case, CI telecom company, which operates in the telecommunications industry, acquired Digicable, a company in the cable network sector, which is at the same level in the supply chain.

4. (c) Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA) Margin

Reason: Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA) Margin Explanation: In the case of Connect India (CI), assessing its

potential value as an acquisition target would involve evaluating its operational efficiency and profitability. The EBITDA Margin, which indicates a company's earnings before non-operating expenses, provides valuable insights into CI's core operational performance, making it a relevant metric for potential acquirers during M&A analysis.

5. **(b)** The risk of fraudulent reporting to mask financial difficulties.

Reason: Given Connect India' financial distress, auditors should prioritize assessing the risk of fraudulent reporting aimed at concealing the company's true financial position. This includes scrutinizing financial statements for potential misstatements and ensuring transparency in reporting.

6. **(d)** Moonlink Telecom can purchase the spectrum if they resolve their legal dispute with the government and prove their financial stability under the IBC, 2016.

Reason: The Insolvency and Bankruptcy Code (IBC), 2016, primarily deals with the resolution of insolvency and bankruptcy for individuals and companies. It ensures that assets are managed efficiently and that the interests of creditors and other stakeholders are protected.

The IBC, 2016, would allow Moonlink Telecom to acquire the spectrum if they can resolve their ongoing legal issues and demonstrate their financial capability and stability. This aligns with the objective of the IBC to ensure orderly resolution of insolvency and protection of stakeholders' interests, including ensuring that buyers are financially stable.

Hence, Option D is the most appropriate answer based on the IBC Code, 2016.

II. Answers to the Descriptive Questions

7. Porter's Five Forces is a framework for analyzing the competitive forces within an industry, which can help understand the intensity of competition and profitability. Applying this model to Connect India (CI) offers insights into the dynamics that contributed to its rise and eventual downfall.

I. **Competitive Rivalry within the Industry:** The intensity of competitive rivalry within the telecom industry was high, driven by several key factors. Market competition was fierce, with CI facing significant challenges from major players like Dtel, M Phone, and IA Cellular. The competition intensified further with the entry of Connect XG in 2016, whose aggressive pricing and free services

disrupted the market dynamics. This led to widespread price wars, compelling companies, including CI, to drastically lower tariffs to retain their market share, consequently reducing profit margins across the industry. Additionally, rapid technological advancements, such as the shift from CDMA to GSM and the advent of 4G, required continuous investment in infrastructure upgrades, further escalating operational costs and competition. In conclusion, the telecom industry was characterized by intense rivalry due to aggressive market competition, frequent price wars, and the need for constant technological advancements.

II. **Threat of New Entrants:** The threat of new entrants in the telecom industry was moderate to high. While significant capital investment for infrastructure and spectrum licenses created high barriers to entry, regulatory changes and emerging market opportunities could lower these barriers. This dynamic was exemplified by the entry of Connect XG, which, backed by substantial capital and innovative strategies, managed to disrupt the market despite these high barriers. XG's successful penetration illustrated how new players with adequate resources could overcome traditional entry barriers and rapidly capture market share. In conclusion, although the telecom industry had high barriers to entry, the potential for market disruption by well-funded and innovative new entrants remained a significant threat.

III. **Bargaining Power of Suppliers:** The bargaining power of suppliers in the telecom industry was low to moderate. Telecom companies depended on equipment suppliers, network infrastructure providers, and technology vendors, but the global abundance of these suppliers diminished the bargaining power of any single supplier. Large telecom companies like CI typically leveraged their scale and volume of business to negotiate favorable terms in contract negotiations. However, specialized technology providers or exclusive suppliers could exert more influence due to their unique offerings. Additionally, the need to acquire spectrum licenses through government auctions added another layer of supplier dependence, as telecom companies had to navigate regulatory frameworks and competitive bidding processes. In conclusion, although the overall bargaining power of suppliers was relatively low, specialized providers and the requirement to secure spectrum licenses could exert more influence in certain areas.

IV. **Bargaining Power of Buyers:** The bargaining power of buyers in the Indian telecom market was high. Consumers had numerous options due to the intense competition among telecom providers, allowing them to easily switch providers for better pricing or service quality. The market was highly price-sensitive, with customers favoring low-cost options, which pressured telecom providers to offer competitive pricing, often at the expense of their margins. Additionally, with multiple providers offering similar services, service quality became a critical differentiation factor. Consequently, CI had to continuously improve its service quality and customer experience to retain its subscriber base. In conclusion, the high bargaining power of buyers in the Indian telecom market forced providers to prioritize competitive pricing and superior service quality to maintain customer loyalty.

V. **Threat of Substitutes:** The threat of substitutes in the telecom industry was moderate. Alternative communication methods, such as internet-based services, posed a significant threat as increasing internet penetration made these services more viable alternatives to traditional telecom offerings. Additionally, the technological convergence of various platforms, including the internet, mobile telephony, and OTT services, broadened the competitive landscape for traditional telecom services. This convergence forced telecom companies to continuously innovate and adapt to remain relevant. In conclusion, while the threat from substitutes was moderate, the ongoing technological convergence and rising popularity of internet-based communication necessitated persistent innovation from traditional telecom providers.

Porter's Five Forces analysis of Connect India highlighted a highly competitive and dynamic environment. CI's decline could be attributed to several key factors: intense competitive rivalry, significant threats from new entrants like Connect XG, and high bargaining power of buyers in a competitive market landscape. Although the bargaining power of suppliers remained relatively low, the rising threat of substitutes from digital communication technologies further pressured traditional telecom business models. CI's inability to effectively navigate these competitive forces, combined with strategic missteps and financial mismanagement, ultimately led to its downfall.

8. Valuing distressed companies like Connect India (CI) for acquisition by XG requires adapting traditional valuation methodologies to account for the specific risks and

uncertainties that these companies face. This involves modifications to the conventional valuation methods to address the issues that arise due to financial and operational distress. Here, we will explore the application of four advanced financial management techniques to the valuation of CI.

1. **Modified Discounted Cash Flow (DCF) Valuation:** This method requires coming up with probability distributions for the cashflows (across all possible outcomes) to estimate the expected cashflow in each period. While computing this cash flow the likelihood of default should be adjusted for. In conjunction with these cashflow estimates, discount rates are also estimated:

   - ♦ Using updated debt to equity ratios and unlevered beta to estimate the cost of equity.
   - ♦ Using updated measures of the default risk of the firm to estimate the cost of debt.

   However, in case of inability to estimate the entire distribution, probability of distress shall be estimated for each period and used as the expected cashflow:

Expected cash flow$_t$ = Cash flow$_t$ * (1 - Probability of distress$_t$)

2. **DCF Valuation + Distress Value:** A DCF valuation values a business as a going concern. However, DCF valuations will understate the value of the firm if there is a possibility that the firm will fail before it reaches stable growth, and the assets will be sold for a value less than the present value of the expected cashflows (a distress sale value).

   Thus, the value of Distressed firm i.e. CI can be computing by following under-mentioned steps:

   I. Value the business as a going concern by looking at the expected cashflows it will have if it follows the path back to financial health.

   II. Determine the probability of distress over the lifetime of the DCF analysis.

   III. Estimate the distress sale value as a percentage of book value or as a percentage of DCF value of equity estimated as a going concern.

   Accordingly following formula can be used to calculate the value of equity of CI.

Value of Equity = DCF value of equity (1 - Probability of distress) + Distress sale value of equity (Probability of distress)

3. **Adjusted Present Value Model:** This approach is based on the logic of separating investment decision from financing decision. Accordingly, first the value of CI is computed without debt (the unlevered firm) and then effect of debt on firm value is adjusted in the same:

Firm Value = Unlevered Firm Value + (Tax Benefits of Debt - Expected Bankruptcy Cost from the Debt)

While the first part can be computed by discounting the free cashflows to the firm at the unlevered cost of equity the second part reflects the present value of the expected tax benefits from the use of debt. The expected bankruptcy cost can be estimated as the difference between the unlevered firm value and the distress sale value:

Expected Bankruptcy Costs = (Unlevered firm value - Distress Sale Value)* Probability of Distress

4. **Relative Valuation:** Relative Valuation multiples such as Revenue and EBITDA multiples are used more popular measures to value distressed firms than healthy firms because multiples such as Price Earnings or Price to Book Value etc. often cannot even be used for a distressed firm. Analysts who are aware of the possibility of distress often consider them subjectively at the point when they compare the multiple for the firm they are analysing to the industry average.

9. (a). As per section 35ABA, in respect of any capital expenditure incurred for acquiring any right to use spectrum for telecommunication services at any time during any previous year and for which payment has actually been made to obtain a right to use spectrum, there shall be allowed for each of the relevant previous years, a deduction equal to the appropriate fraction of the amount of such expenditure.

Where a part of the spectrum is transferred in a previous year and the proceeds does not exceed the expenditure incurred remaining unallowed, the unallowed expenditure would be amortized in the following manner:

(i) Subtract the proceeds of transfer from the expenditure remaining unallowed.

(ii) Divide the remainder by the number of relevant previous years that have not expired at the beginning of the previous year during which the spectrum is transferred.

- Total expenditure incurred for acquiring the spectrum = ₹ 1,000 crores
- Number of relevant previous years = 20 years
- Deduction claimed till the previous year 2022-23 = ₹ 1,000 crores / 20 years × 3 years = ₹ 150 crores
- Expenditure remaining unallowed as on April 1, 2023 = ₹ 1,000 crores - ₹ 150 crores = ₹ 850 crores
- Proceeds from the transfer of a part of the spectrum = ₹ 300 crores
- Number of unexpired relevant previous years as on April 1, 2023 = 17 years

Computation of deduction available under section 35ABA for the previous year 2023-24:

Expenditure remaining unallowed - Proceeds from transfer of part of spectrum = ₹ 850 crores - ₹ 300 crores = ₹ 550 crores

Deduction for the previous year 2023-24 = ₹ 550 crores / 17 years = ₹ 32.35 crores

Since the proceeds from the transfer of a part of the spectrum (₹ 300 crores) do not exceed the expenditure remaining unallowed (₹ 850 crores), no amount would be chargeable to tax as profits and gains of business under section 35ABA in the P.Y. 2023-24.

Therefore, the deduction available to Connect XG under section 35ABA for the previous year 2023-24 is ₹ 32.35 crores, and no amount is chargeable to tax.

(b) Where the whole or any part of the spectrum is transferred and the proceeds of the transfer exceed the amount of the expenditure incurred remaining unallowed, the excess amount or expenditure allowed till date (i.e., difference between expenditure incurred to obtain spectrum and the expenditure remain unallowed), whichever is less, shall be chargeable to tax as profits and gains of business in the previous year in which the spectrum has been transferred.

Since the proceeds from the transfer of a part of the spectrum (₹ 900 crores) exceeds the expenditure remaining unallowed (₹ 850 crores), the lower of ₹ 50 crores or ₹ 150 crores, being expenditure allowed till date would be chargeable to tax as profits and gains of business under section 35ABA in the P.Y. 2023-24.

CASE STUDY 8

Standard Tea Private Limited (STPL) was established in 1935 headquartered in Kolkata. The company is privately owned by the Ghanshyam family members, who have been in the tea business for the past 3 generations. Shri Ghanshyam started out as a broker in the Siliguri Auction centre. In due course, he started a tea blending and packaging company, STPL in Kolkata. Tea leaves are blended and packed at its production facilities and sold further to tea distributors. Tea distributors in turn sell the packages to other smaller wholesalers or large retail outlets. Retail chains across India stock tea packages blended by STPL.

In smaller cities and towns, where there is no presence of proper distributors, STPL has local sales agents that it hires on contract to sell tea to small grocery stores and other local shops (SGSs). Goods are sent to these local agents on consignment. Tea packages have a long shelf life and can be stored up to a year if stored in appropriate conditions. STPL commands a moderate 8% market share in terms of sales in the Indian market.

STPL has been a profitable business for most of the years of its existence. The past many years have seen significant inflationary trends in the economy. Like many other companies, STPL too has been enduring the increase in tea leaf price, which is the primary raw material. To combat reducing profit margins due to inflation, it has concocted a uniform blend that it sells under the brand name “A1 Tea”. The blend is prepared by mixing few popular tea flavours into one. This concoction was done with the help of an expert tea sommelier a decade back. STPL has used this same composition over the last many years. The tea that STPL prepares under the “A1 Tea” is of the black tea variety, which is the most popular tea variety consumed in India.

The Indian marketplace is crowded with many tea companies like STPL. In retail outlets and grocery stores shelves stocking tea beverage have many brands stocked together. There is nothing much to differentiate STPL’s “A1 Tea” brand from the rest. Brands have to fight to gain visibility among customers and this is done using attractive packaging, increasing advertisement spend etc. Hence, customers are more price sensitive rather than conscious about quality of tea.

Today, in 2023 the total Indian Tea market is estimated to be ₹ 34,400 crores with branded business constituting approximately 74% of the total market value. The global tea market is estimated to range between $45-50 billion, with primary demand stemming from the Black Tea segment. There is a growing interest in other segments such as Green Tea, Fruit & Herbal,

Decaf, Speciality, among others. Despite optimistic prospects, the management at STPL observes stagnation in tea sales rather than growth.

Shri Narayan, son of Shri Ghanshyam is the CEO of STPL. Last month, he called the senior management of the company to understand the reason for stagnating sales. This month, there was a follow up meeting where the findings of the investigations detailed above, were presented to him. Anticipating heated arguments, Shri Narayan on behalf of STPL, has hired you as a consultant to guide the company on ways to improve its sales and increase its market share. He wants to focus on the smaller market segment, which is the sales in smaller towns and cities that are handled by contract based local sales agents. Local agents need to travel on an average 60 kms a day meeting SGSs who are willing to stock tea. It was found that local sales agents were doing business with only 25% of the SGSs within their area of operation.

When you along with Sally, the sales manager, met the local sales agents here is what they had to say: "A1 Tea" has a good taste and has reasonable preference among customers. There are not too many companies selling tea in our areas, hence choice is lesser, therefore competition is also lesser. STPL can establish a good market presence here. However, we need to travel on an average 60 kms just to make a sales call. STPL pays us 2% commission for each package of "A1 Tea" sold to the local grocer. This hardly covers the expenses we incur on travel. Instead, we call up once a month to check if the store needs fresh supplies. This will at least save the travel cost. Only then it is viable to sell "A1 Tea" here. Otherwise, the company has to increase the commission rate to at least 8% to make it worth the travel we need to undertake."

It has now been two weeks since you have started working on the assignment. Various discussions have been made with different levels of management and operational staff. Various business models have been discussed with Shri Narayan. Eventually, after many iterations, the senior management agrees that distribution channel will be changed. The current system of consignment sales will be discontinued. The proposal is explained below:

STPL wishes to adopt a new distribution channel, that will be to deliver "A1 Tea" directly to the SGSs in smaller towns. Each SGS can login to the specially designed portal and place an order for "A1 Tea" directly with STPL. Depending on the average demand by the end user STPL has decided to offer its tea packages in 1/2kg pack, 1 kg pack and 2 kg pack. Against each type of package, the local store (SGS) can choose the quantity required. Once received, STPL will then process the order, bundle the entire order into one package that will be delivered to the local store within 3 days of order. The local store has to settle the entire amount due electronically through bank transfer or digital payment systems like UPI, digital wallet etc. while placing the order. In order to increase the popularity of "A1 Tea" among the end use consumers,

it is suggested to offer teacups along with the tea packages. Advertising and promotional activities like free tea tasting stalls in popular spots where people get together (like parks, shopping centres, railways stations, bus stops) will be undertaken.

STPL has a policy agreement with the grocers (SGSs), that "A1 Tea" packages cannot be opened and sold in loose. This is so in order to maintain the quality of tea. Quality of loose tea will not be the same as that sold in airtight packages. Lower quality will affect customer perception of "A1 Tea". This can negatively impact STPL's brand value. SGSs can provide feedback and register complaints with STPL either through the portal or by calling up the service department that is going to be set up for this purpose.

By increasing its market reach, sales from this expansion plan are expected to contribute up to 15% of STPL's total revenue. This is substantially more than the current contribution of 1% of total revenue.

STPL has accepted and implemented the plan successfully. The company is now able to sell its tea directly to the SGSs based on their online orders. There is substantial increase in volume of sales through this revenue channel. The company now wants to develop an MIS report that gives detailed information about the sales order volume and profitability. The MIS aims to have the information captured at state level, regional level right down to customer level. The company policies under this plan include:

- Discount of 5% is given on selling price if each order size is cumulatively more than 50 kgs. The order can comprise of any combination of ½ kg. pack, 1 kg. pack and 2 kgs. pack.
- STPL delivers the order to the SGS. At the same time, it offers flexibility to the SGSs to arrange for their own transport. In case the SGS arranges for their transport, further discount of 8% is given on the selling price of each tea pack.
- Selling price of tea is ₹ 300 per kg. Therefore, 1 kg. package sells at ₹ 300 each, 2 kg. package sells at ₹ 600 each and ½ kg. package sells at ₹ 150 each.
- Variable cost per kg. is ₹ 200 per kg.
- Order processing costs are ₹ 2,000 per order.
- Delivery costs, where STPL is arranging for delivery ₹ 3,000 per delivery.
- Delivery will be within 3 days of placing the order. If there is a rush order, typically delivery within a single day, the cost of delivery would be ₹ 5,000 per delivery.

Below is an extract of the MIS for the town of Palani, Tamil Nadu. It has 3 SGSs: Customer A, Customer B and Customer C.

Particulars	Customer A	Customer B	Customer C
Total sales in a month (kgs.)	250	400	1,020
Number of orders	2	2	15
Number of deliveries – normal	2	-	10
Number of deliveries – rush	-	-	5

Order quantity is the same for each order placed by each customer.

Work is underway to adopt the new distribution channel of doing business directly with SGSs. It might take upto 2 years to completely implement this plan.

The board of directors of STPL have been working on expanding the plant capacity to meet the requirements of the current expansion plan. A set of 10 machines need to be bought for this project. The gestation period would be 2 years, whereas the machines have to be ordered and imported from USA. After this period, the cash flow will start increasing gradually over 15 years. Overall, the expansion project is expected to generate positive cash flows. For this, STPL will have to settle an import bill for $1,30,000. There are two options:

(i) Pay immediately by availing overdraft facility. Currently it has clean overdraft limit and bank charges 14 percent per annum for availing the same facility.

(ii) Pay after three months with interest @ 7 percent per annum and cover position in forward market.

The exchange rates in the market are as follows:

Spot rate (₹ /$): 82.19/ 82.21

3-Months forward rate (₹ /$): 82.98/ 83.01

I. Multiple Choice Questions

1. STPL has given another consulting assignment to you to have an in-depth industry analysis to understand STPL's current position within the industry, understanding the value chain, identifying prospects for growth, future scenario etc. This would give the company a correct and fair view about the feasibility of its future acquisition plans. This study is being undertaken independently of the expansion plans mentioned in above in

the case study, which also includes capital assets acquisition project of ~₹ 1 crore mentioned in previous section.

The study lasted a minimum of four months, and its findings were presented to the senior management. To summarize the findings of the study, it concluded that *"muted prices plus rising cost spells a stale brew for tea companies.* ***The domestic market has saturated with penetration as high as 80% of the tea drinking population. There are few fragments like small town markets where there is potential for some growth.*** *However, this apart there is limited the growth potential for almost all companies within the industry including STPL. The wages of workers have been revised every three years. This is pertinent because tea industry is very cost intensive, with labour cost accounting for at least 60% of the cost of production. Industry margins are under pressure. STPL's overall performance to remain a sustainable business will depend on its ability to sell at remunerative prices and manage costs efficiently."*

Given this bleak outlook, STPL has reached a conclusion that it has reached a stage of maturity in this business, which of the following actions by the management of the company will not be in the overall interests of the shareholders of the company?

Given this bleak outlook, STPL has reached a conclusion that it has reached a stage of maturity in this business, which of the following actions by the management will not be in the overall interests of the company?

(a) Acquire tea plantation estates if available at attractive rates (Backward Integration)

(b) Open company owned stores in major metros in order to sell A1 Tea to customers directly (Forward integration)

(c) Introduce product lines selling economy, popular and premium grade tea by promoting tea in as an aspirational beverage for health or lifestyle choice

(d) After appropriate due diligence in terms of business feasibility, acquire promising start ups which have the potential to disrupt the tea ecosystem

2 **STPL chooses to pursue vertical integration by acquiring the tea plantation of a neighbouring country, SL.** Due to the recent economic crisis in SL, it is straddled with high unemployment rates. The famed tea industry in SL is also reeling under the crisis. Many plantation companies are going bankrupt. STPL decides to explore acquisitions in this market, where acquisitions of tea estates producing high quality tea leaves may be available at reasonable rates. It opts to invest in SL's 200-acre plantation. CFO has identified an investment opportunity and feels confident that it will be approved by the

board. The board generally favours acquiring distressed assets if any in neighbouring countries, as this provides supply chain benefits. Approximately a year ago, STPL acquired a Testing & Research Laboratory in a neighbouring country NP exclusively for tea-related research.

The Chief Legal Officer cautions against moving forward with the fresh investment, emphasizing its non-Indian company nature. Nevertheless, the CFO argues that the investment is viable, citing laboratory acquisition in country NP where no approval was required. The Chief Legal Officer, however, presents the following information:

Particulars	Amount ₹ Crores
STPL's Equity Investment - >51% in Testing & Research Laboratory	1,100
Bank Guarantee provided to NP's Banks on behalf of Testing & Research Laboratory	1,600
SL's Based Company Proposed Investment Value	750
Net Worth of STPL	1,100
Bonus Shares capitalised through Retained Earnings	250

Assess the CFO's assertion regarding PTPL's ability to proceed with the investment in SL's 200-acre plantation.

(a) The CFO is correct, and STPL can make this investment as there are no restrictions imposed by Indian Government.

(b) CFO is correct as Chief Law officer is not aware of recent amendments of FEMA which advocates ease of foreign investments by Indian Companies.

(c) The CFO is incorrect. However, if the investment value is reduced by ₹ 50 Crores, then STPL can proceed with the proposed investment.

(d) The CFO is correct, and STPL can proceed with the proposed investment. Even after this investment, STPL still have a remaining foreign investment limit of ₹ 1,550 Crores.

3. **To fund the investment of ~$85 million in SL's 200-acre plantation**, STPL plans to raise $30 million through debt. With the intention of maintaining certainty in future interest payments, STPL aims to secure a fixed interest rate. STPL can borrow for one year at a fixed rate of 6% or at a floating rate of 2% above SOFR. Management of STPL decides to enter into a swap arrangement with Company Tima. Company Tima also wishes to raise $30 Million. To take advantage of any fall in interest rates Tima is interested in

borrowing funds at Floating Rate. However, it can only borrow funds at fixed rate of 7% p.a. or at SOFR +4%, because of lower credit rating in comparison of STPL Tea.

What effective rate will each end up paying if both have agreed to enter into a Swap agreement and split the resultant gain equally.

(a) STPL: 5.5% and Tima: SOFR +3.5%

(b) STPL: 7% and Tima: SOFR +2%

(c) STPL: SOFR +2% and Tima: 7%

(d) STPL: SOFR +3.5% and Tima: 5.5%

4. As understood from the case study, that industry margins are under pressure due to prolonged high inflation. Survival of companies and future prospects of the tea industry's overall performance to remain a sustainable business will depend on its ability to sell at remunerative prices and manage costs efficiently.

Supply chain highlights the interdependency of each part of the chain. When managing a supply chain, a business may wish to ensure that the entire industry eco system (other entities) also remain sustainable. Entities should have sufficient cash and/or profits. Which of the following reasons explains the reason for this?

(a) Sustainable business ensure that the business has sufficient information on all parts of its supply chain

(b) Sustainable business ensures quality throughout the supply chain

(c) Sustainable business ensures maximum collaboration throughout the supply chain

(d) Sustainable business ensures ongoing demand for the business's products for which continuous supply is also needed

5. STPL is using "Porter's Five Model" to examine key aspects of tea industry and the impact that some of its strategic decisions can have on various forces. One of the points being considered is the decision to adopt the new distribution channel of directly reaching out to SGSs. This is a novel distribution system in the industry. Which of the following statements are true?

(a) Threat of substitute has been lowered

(b) Risk of competitive rivalry has been lowered

(c) Threat of new entrants has been lowered

(d) Bargaining power of suppliers has been lowered

II. Descriptive Questions

A meeting has been set up to discuss the new plan. As the management consultant, you are the lead presenter of the plan. The question answer session is now open. Below is a sample of few of the questions that you had to answer during the meeting. You are requested to provide your detailed comments and answers to these.

6. What is the rationale behind adopting the new distribution channel* of doing business directly with SGSs? ANALYSE. (note- Channel is a component of "Business Model Canvas")

7. Provide a critical ANALYSIS of the difference in profitability of each customer.

8. STPL seeks your ADVICE on the option to be chosen to hedge the foreign exchange risk.

ANSWERS TO THE CASE STUDY 8

I. Answers to the Multiple Choice Questions

1. (b) Open company owned stores in major metros in order to sell A1 Tea to customers directly (Forward integration).

Reason: STPL has reached a stage of maturity in the business. The industry study mentions that the market is already saturated with penetration levels as high as 80%. Only limited scope for market growth exists like that in small towns and cities. Hence, opening company owned stores in major metros in order to sell "A1 Tea" directly to customers will not be in the overall interests of the company.

2. (c) The CFO is incorrect. However, if the investment value is reduced by ₹ 50 Crore, then STPL can proceed with the proposed investment.

Reason: As per Schedule I, Part 3 of the Foreign Exchange Management (Overseas Investment) Rules 2022, (1) the total financial commitment made by an Indian entity in all the foreign entities taken together at the time of undertaking such commitment shall not exceed 400 percent of its net worth as on the date of the last audited balance sheet or as directed by the Reserve

Bank, (2) The total financial commitment referred to in sub-paragraph (1) shall not include capitalisation of retained earnings for reckoning such limit but shall include −

(i) utilisation of the amount raised by the issue of American Depository Receipts or Global Depositary Receipts and stock- swap of such receipts; and

(ii) utilisation of the proceeds from External Commercial Borrowings to the extent the corresponding pledge or creation of charge on assets to raise such borrowings has not already been reckoned towards the above limit.

Financial Commitment includes amount of Investment made by a Person Resident in India by way of Overseas Direct Investment, Debts other than Overseas Portfolio Investments and Non-Fund Based Liabilities. Bank Guarantee is one of the Non-Fund Based Liabilities.

Overseas Direct Investments includes investment by way of −

(i) Acquisition of unlisted equity capital of a foreign entity or

(ii) Subscription as a part of Memorandum of Association of foreign entity,

(iii) Investment in >= 10% of the paid-up equity share capital or

(iv) Investment with control where investment is <10% of the paid- up equity share capital of listed foreign entity

The computations are as follows:

	Particulars	Amount ₹ Crore
A.	STPL's Equity Investment - >51% in Testing & Research Laboratory	1,100
B.	Bank Guarantee provided to NP's Banks on behalf of Testing & Research Laboratory	1,600
	(i) Total Current Foreign Direct Investment (A+B)	2,700
C.	Net Worth of STPL	1,100

D.	Bonus Component in the Net Worth of Company	250
	(ii) Total Financial Commitment Allowed (C-D)×400%	3,400
E.	Possible Further Investment (ii) - (i)	700
F.	SL's Based Company Proposed Investment Value	750
Reduction required in Investment Value (F-E)		50

3. (a) STPL: 5.5% and Tima: SOFR +3.5%.

Reason: There is bigger difference in the variable rate so to take advantage of this, Tima will borrow fixed and STPL then has to borrow at a variable rate. Accordingly, Swap arrangement shall be carried out as follows:

Working

	Tima	STPL	Difference
Fixed	7%	6%	1%
Floating	S + 4%	S + 2%	2%
Absolute Difference			1%
Split of gain equally	+0.5%	+0.5%	-1%
Net Interest	S + 3.5%	5.5%	

4. (d) Sustainable business ensures ongoing demand for the business's products for which continuous supply is also needed.

Reason: Unless there is a demand for the product, the need for suppliers won't be required. Therefore, in order to survive, companies like STPL need to earn money by charging remunerative prices. This means that need to recoup their costs and earn regular profits. At the same time, if the prices charged are very high, demand for the product will reduce. This will not sustain STPL or companies like it.

The other way of improving margins is to cut costs. This is done by procuring material at low prices, paying low wages, using cheaper resources etc. However, unless the supplier finds it remunerative to sell, STPL cannot procure its raw material. So, the supplier should also benefit from sale to

STPL. Similarly, very low wages will lead to attrition among workers, very cheap resources will lead to quality issues. Everyone does business to make profits and customers derive value at reasonable prices. Each link in the supply chain should ensure that the ecosystem benefits allowing for normal profits, sufficient cash resources to be earned. Otherwise, the industry will not sustain.

5. **(b)** Risk of competitive rivalry has been lowered.

Reason: Since this is a novel distribution system in the industry, STPL has a first mover advantage over its rivals. This lowers the risk of competitive rivalry. Sustaining this advantage however depends on whether the rivals are able to replicate and better this new distribution channel.

II. Answers to the Descriptive Questions

6. Doing business directly with SGSs through the new distribution channel brings STPL much closer to SGSs. These stores are potential point of sale of tea to the end user. STPL has so far relied on local sales agents to connect with these SGSs. However, the agents are not motivated enough to drive sales. It was found that local sales agents were doing business with only 25% of the SGSs within their area of operation. The margins of the company are already squeezed due to inflationary pressures. In this background, agents are already demanding a fourfold increase in commission from 2% to 8%. However, given their current performance, it might not be in STPL's interest to use their services since it's not at all effective. There is no assurance of better service by paying this extra cost. By directly interacting with the stores/ shops, STPL *will have a direct channel of communication* and can get complete and proper feedback directly from them. It is far more effective to use the specially designed portal as a channel (way) to reach out to them since the target segment is geographically spread out over a larger area. The dedicated customer service department can gather information that will help the company improve its operations and resolve customer complaints in a much quicker and more effective manner. *Hence*, given the geographical spread of the target customer segment, lack of effective support from consignment agents, inflationary cost trends that hike up costs, better connect with the market etc., it makes good business sense to follow the newer distribution channel of directly selling to SGSs.

7. Each of the customers places an order above 50 kgs. per order. Customer A's order size is 125 kgs. per order (250 kgs. / 2 orders), Customer B's order size is 200 kgs. (400 kgs. / 2 orders) and Customer C's order size is approximately 68 kgs. (1,020 kgs. / 15 orders). Therefore, all of them can avail the 5% quantity discount. This amounts to ₹ 15 per kg. (5% of ₹ 300 per kg.). Delivery discount of 8% further reduction can be given only to Customer B, since this is the only customer that arranges for its own delivery. This amounts to further reduction of ₹ 24 per kg. (8% of ₹ 300 per kg.). The individual customer profitability can be calculated as below:

Particulars	Customer A	Customer B	Customer C
Selling Price per kg.	300	300	300
Less: Quantity Discount - 5% of selling price	15	15	15
Less: Delivery Discount - 8% of selling price	---	24	---
Net Selling Price (₹)	285	261	285
Less: Variable Cost per kg. (₹)	200	200	200
Contribution per kg. (₹)	85	61	85
Total Sales in a month (kgs.)	250	400	1,020
Total Contribution (₹)	21,250	24,400	86,700
Less: Overheads (₹)			
Delivery Cost	6,000	---	30,000
Ordering Cost	4,000	4,000	30,000
Extra Cost - rush delivery	---	---	25,000
Profit per Customer (₹)	11,250	20,400	1,700

Analysis

It can be seen that Customer B is the most profitable, followed by Customer A. Customer C is the least profitable. In terms of quantum, Customer A buys the least, however the number of orders are just 2. Hence, the fixed order cost of ₹ 2,000 per order is absorbed over a larger order size. This is true with regards to Customer B also since a larger order size absorbs the fixed order cost of ₹ 2,000 per order. It can be noticed that out of the 15 orders relating to Customer C, 5 orders are rush orders

requiring delivery within a single day. The cost of these rush order delivery is much higher at ₹ 5,000 per delivery. Therefore, despite being the largest customer among the three, Customer C is the least profitable. STPL can seek to pass on the rush delivery cost to the customer instead of bearing it entirely. Since rush order deliveries are 1/3 of the total orders placed by Customer C, STPL can seek to have an understanding with the customer and try to find a way to reduce this. Charging for rush deliveries will deter the customers from placing unnecessary and unreasonable requests. This will help to improve profitability derived from the customer.

Customer B is extended an additional discount of ₹ 24 per kg. (8% of selling price) since the customer arranges for their own delivery. The normal delivery cost to Palani is ₹ 3,000 per delivery. Customer B orders 400 kgs. in a month by placing 2 orders. Hence, if STPL had shipped the goods, it could have done it at ₹ 15 per kg. (₹ 3,000 × 2 orders = ₹ 6,000 spread over 400 kgs.). Instead, due its pricing policy it is incurring an extra cost of ₹ 9 per kg. for the orders by Customer B. Here, STPL can either reduce the discount to 5% of selling price (₹ 15 / ₹ 300) or discontinue this policy and arrange for delivery of goods to Customer B.

It can hence be concluded that volume of sales alone does not guarantee higher profits as in the case of Customer C. Similarly, faulty pricing policies can also hurt profitability, as in the case of Customer B.

8. ***If STPL pays now***, it will have to buy US$ in Spot Market by availing overdraft facility. Accordingly, the outflow under this option will be:

	₹
Amount required to purchase $1,30,000 [$1,30,000 × ₹ 82.21]	1,06,87,300
Add: Overdraft Interest for 3 months @14% p.a.	3,74,056
	1,10,61,356

If STPL makes payment after 3 months, then, it will have to pay interest for 3 months @7% p.a. and then to buy $ in forward market. The outflow under this option will be as follows:

	$
Amount of Bill	1,30,000
Add: Interest for 3 months @7% p.a.	2,275
	1,32,275

Amount to be paid in Indian Rupee after 3 months under the forward purchase contract - ₹ 1,09,80,148 (US$1,32,275 × ₹ 83.01).

Advise: Since outflow of cash is least in (ii) option, hence, it should be opted for.

CASE STUDY 9

Sahana is MBA Graduate from IIM Bangalore. Sahana and her father incorporated a company 'Sah Fashions Ltd.' to set up a boutique and chain of readymade garment stores to support their family business of cotton and yarn mills. She was able to manage the accounting and taxation part of her business by herself in the initial stages. Considering the business expansion, she was evaluating to hire a professional consultant who would support in all business matters including taxation and accounting. She reached out to her old friend, Madan, a Practising Chartered Accountant to seek his help on accounting and compliance matters relating to the Company.

Madan set up his own Proprietorship firm and has been in practice specialising in Audit and Taxation since 10 years. When Sahana contacted Madan for professional help, he was more than glad to support her. They met up at a coffee shop to discuss the details of the engagement. During the conversation, Madan tells her that times have changed and so have the ways of presenting accounts of any business as per the financial reporting framework. He explains how the preparation of the Financial Statements is now regularized in such a way where all such Financial Statements shall have a consistency/ uniformity across the industry (with few exceptions e.g. specially regulated financial statements). In addition, the users of these Financial Statements would also have an assurance of complying with basic framework. He also gives her an overview of latest changes in the income tax and GST which could have an impact on her business. After a detailed conversation on accounting and taxation aspects, he asks Sahana to brief him about her business and the issues she is facing. The meeting gets more formal as Sahana calls Murari, the Accountant working in her Company to the meeting.

Sahana explains the following open issues to Madan:

Issue 1

Sahana opines that Murari is not computing the depreciation on the Plant and Machinery appropriately:

	Particulars	**₹ Lakhs**
(1)	WDV of Plant & Machine (P & M)	30
(2)	New P & M purchased and put to use on 8th June 2023*	20

(3)	New P & M acquired and put to use on 15th December 2023*	8
(4)	Computer acquired and installed on 2nd January 2024	3

* Qualified for additional depreciation @20% p.a.

As per Murari's workings, total maximum depreciation on machinery @15% comes to ₹ 8.7 Lakhs and on computer @40% comes to ₹ 1.2 Lakhs.

Issue 2

On 1st April 2022, Sah Fashions Ltd acquired 100% of Spun Ltd for ₹ 5 Lakhs, which was into cotton spinning business. The fair value of the net identifiable assets of Spun Ltd was ₹ 4.5 Lakhs and goodwill was ₹ 0.5 Lakhs. On 31st March 2024, the government changed its policy on textile sector having adverse impact on business of companies like Spun Ltd.

Internal discussion on government policies indicate that revenue of Spun Ltd is estimated to fall by 20% in coming three to five years. The adverse effect on market place and strict regulatory conditions indicate impairment. As a result, Spun Ltd. has to estimate the recoverable amount of goodwill and net assets on 31st March 2024.

Sah Fashions Ltd. uses straight line depreciation. The useful life of Spun Ltd assets is estimated to be 15 years with no residual value. Further, no independent cash inflows can be identified to any individual assets. So the entire operation of Spun Ltd is to be treated as a cash generating unit (CGU). Due to the regulatory entangle, it is not possible to determine the selling price of Spun Ltd. as a CGU. Its value in use is estimated by the management at₹ 3.02 Lakhs.

Issue 3

Mr. Geet was appointed as the new Managing Director of the company on 05.10.2023 in place of Mr. Suresh. The company decided to pay remuneration to Mr. Geet as per Section 197 (4) of the Companies Act, 2013. Mr. Baman, one of the members of the company, wanted to inspect contract of service entered into by the company with Mr. Geet for assigning him the office of Managing Director but he was denied to have such inspection on the grounds that the contract with Mr. Geet was not in writing.

Issue 4

Company at the Annual General Meeting (AGM) held on 30th September 2021 appointed Gana as a Non-Executive Director on the board of the Company for a period of three years. On 2nd October 2021, Gana met with an accident and died on the spot. The Board of

Directors of the Company on 16th October 2021 appointed Hero to fill the casual vacancy so created. Appointment of Hero was made for a term of three years by the Board unconditionally. The next General Meeting (GM) was held on 29th October 2021.

Issue 5

Besides Company related matters, Sahana asked Madan to advise her in her individual tax matters too. She is planning to buy a residential flat for her own residence, which is priced at ₹ 48.50 Lakhs. The person selling the flat, Rainbow is a NRI as per the provisions of Income-tax Act, 1961 and he will be visiting India to execute the sale deed. After the title gets transferred, the flat will be renovated with a total cost of ₹ 60 Lakhs approximately. Madan was quite astonished when he got to know that the renovation cost is more than the purchase price of the flat. Sahana informed Madan that she is purchasing the flat due to her father's emotional attachment with the locality and evaluating to finalise the contractor for the renovation work to make the interiors as per her liking. Apparently, Murari informed her that there would not be any compliance under the Income-tax Act, 1961 towards flat purchased and proposed renovation.

I. Multiple Choice Questions

1. Is the maximum depreciation allowable under Income-tax Act, 1961 calculated by Murari correct? If not, what is the maximum allowable depreciation as per details given in Issue 1?

   (a) No, the depreciation calculated is wrong and the correct maximum depreciation should be ₹ 14.3 Lakhs

   (b) No, the depreciation calculated is wrong and the correct maximum depreciation should be ₹ 14.9 Lakhs

   (c) No, the depreciation calculated is wrong and the correct maximum depreciation should be ₹ 13.5 Lakhs

   (d) No, the depreciation calculated is wrong and the correct maximum depreciation should be ₹ 12.9 Lakhs

2. What is the amount of impairment loss which Sah Fashions Ltd is required to transfer to Statement of profit and Loss and how the same should be allocated?

   (a) Impairment loss is ₹ 1.98 Lakhs and the same should be allocated to goodwill and other assets proportionately.

(b) Impairment loss is ₹ 1.38 Lakhs and the same should be allocated to goodwill and other assets proportionately.

(c) Impairment loss is ₹ 1.68 Lakhs and the same should be allocated first to goodwill and then the balance to all other assets.

(d) Impairment loss is ₹ 1.38 Lakhs and the same should be allocated first to goodwill and then the balance to all other assets.

3. Regarding the request of Mr. Baman to inspect the contract of service entered by company with Mr. Geet, MD, identify the incorrect statement out of followings;

i. Such contract of service shall be kept at registered office of the company.

ii. Member may inspect the contract of service only after payment of prescribed fee

iii. Member can inspect the contract of service with MD or WTD only if authorised by Article.

(a) i, ii, and iii

(b) i and ii

(c) i and iii

(d) ii and iii

4. Considering the facts in Issue 4, is appointment of Hero as a director of the Company valid?

(a) Appointment of Hero by Board of Directors is not valid as it is against the provisions of the Companies Act, 2013 and he should have been appointed by the members in extra ordinary general meeting.

(b) Appointment of Hero by Board of Directors is valid but should be approved by members in general meeting held on 29th October 2021.

(c) Appointment of Hero by Board of Directors is valid, as the approval of shareholders is not required for appointment of directors.

(d) Appointment of Hero by Board of Directors is not valid as a director cannot be immediately appointed in place of director who expires.

5. Is Sahana not required to comply with any provisions under Income-tax Act, 1961, considering her individual tax returns are not subject to audit under the provisions of Income-tax Act, 1961?

   (a) TDS is required to be deducted u/s 194-IA on purchase of property, but no TDS is required to be deducted on contract work of renovation as individuals are not required to deduct TDS.

   (b) TDS is required to be deducted u/s 195 on purchase of property and also TDS is required to be deducted on contract work of renovation as the contract value is ₹ 60 Lakhs.

   (c) TDS is not required to be deducted u/s 195, as the amount of purchase consideration is less than ₹ 50 Lakhs but TDS is required to be deducted on contract work of renovation as the contract value is ₹ 60 Lakhs.

   (d) TDS is not required to be deducted u/s 194-IA as the amount of purchase consideration is less than ₹ 50 Lakhs and no TDS is required to be deducted on contract work of renovation as individuals are not required to deduct TDS.

II. Descriptive Questions

6. Sahana is intrigued by the concept of impairment and wants to understand, if an asset once impaired, can it be reversed. In this context:

   (i) Explain in brief the accounting for reversal of impairment.

   (ii) Source of information which indicates reversal of impairment loss

7. Sahana wants to know if her Company missed some invoices while claiming GST ITC, till what time that ITC can be claimed. She believes the same may be taken till filing GSTR 3B return for the month of March of the concerned financial year. Is her view appropriate?

8. "The executive and non-executive directors have different roles and responsibilities. The responsibility of independent directors with reference to financial reporting and approval, as part of an Audit Committee requires a special mention." Explain with examples.

ANSWERS TO THE CASE STUDY 9

I. Answers to the Multiple Choice Questions

1 (c) No, the depreciation calculated is wrong and the correct maximum depreciation should be ₹ 13.5 Lakhs

Reason: Maximum Depreciation as follows

Particulars	Plant & Machinery @ 15% (₹ in lakhs)	Computer @ 40% (₹ in lakhs)
Normal Depreciation @15% on ₹ 50.00 Lakhs (30+20)	7.5	
@7.5 on ₹ 8.00 Lakhs – put to use for less 180 days	0.6	
@ 20% on ₹ 3.00 Lakhs – Put to use for less than 180 days		0.6
Additional Depreciation @ 20% on ₹ 20.00 Lakhs (new machinery)	4.0	
Additional Depreciation @ 10% on Rs. 8.00 Lakhs (new machinery) put to use for less than 180 days	0.8	
TOTAL	**12.9**	**0.6**

The answer is ₹ 13.5 lakhs

2 (d) Impairment loss is ₹ 1.38 Lakhs and the same should be allocated first to goodwill and then the balance to all other assets.

Reason: Calculation of Impairment loss

	Goodwill	Other assets	Total Lakhs ₹
Historical Cost	0.5	4.5	5
Accumulated Depreciation (4.5/15) X 2	-	(0.6)	(0.6)
Carrying Amount	0.5	3.9	4.4
Impairment Loss	(0.5)	(0.88)	(1.38)
	--		

Revised Carrying Amount

Impairment Loss = Carrying Amount – Recoverable Amount (₹ 4.4 - ₹ 3.2) = 1.38 is charged in statement of profit and loss for the period end

Impairment loss is allocated first to goodwill ₹ 0.5 and remaining loss of ₹ 0.88 (1.38-0.5) as impairment loss is allocated to the other assets

3 (d) ii and iii

Reason: The register of directors and key managerial personnel shall be kept open for inspection during business hours. The members shall have the right to take extracts therefrom and copies thereof on request and the same will be provided to them within 30 days free of cost. [Section 171(1)(a) of the Companies Act, 2013]

4 (b) Appointment of Hero by Board of Directors is valid but should be approved by members in general meeting held on 29th October 2021.

Reason: Casual Vacancy [Section 161(4)]: According to this section:

(i) if the office of any director appointed by the company in general meeting is vacated before his term of office expires in the normal course, the resulting casual vacancy may, in default of and subject to any regulations in the articles of the company, be filled by the Board of Directors at a meeting of the Board which shall be subsequently approved by members in the immediate next general meeting.

(ii) Any person so appointed shall hold office only up to the date up to which the director in whose place he is appointed would have held office if it had not been vacated.

5 (b) TDS is required to be deducted u/s 195 on purchase of property and also TDS is required to be deducted on contract work of renovation as the contract value is ₹ 60 Lakhs.

Reason: Section 194-IA requires every transferee responsible for paying any sum as consideration for transfer of immovable property (land, other than agricultural land, or building or part of building) to deduct tax, at the rate of 1% of higher of consideration and stamp duty value, at the time of credit of such sum to the account of the **resident transferor** or at the time of payment of such consideration to the resident transferor, whichever is earlier. However, no tax is

required to be deducted where the consideration for transfer of an immovable property and stamp duty value of such property, both are less than ₹ 50 lakhs.

TDS is required to be deducted u/s 195 on purchase of property as payment is to be made to a NRI and also TDS is required to be deducted on contract work of renovation as the contract value exceeds ₹ 50.00 Lakhs i.e., ₹ 60.00 Lakhs.

II. Answers to the Descriptive Questions

6. (i) Accounting for reversal of impairment (Paragraphs 110-116 of Ind AS 36)

The increased carrying amount of an asset other than goodwill attributable to a reversal of an impairment loss shall not exceed the carrying amount that would have been determined (net of amortization or depreciation) had no impairment loss been recognized for the asset in prior years. Any increase in excess of this amount would be a revaluation and would be accounted for under the appropriate Standard (e.g. Ind AS 16 Property, Plant and Equipment).

A reversal of an impairment loss for an asset other than goodwill is recognized immediately in profit or loss, unless the asset is carried at revalued amount in accordance with another Ind AS. Any reversal of an impairment loss of a revalued asset shall be treated as a revaluation increase in accordance with that other
Ind AS.

A reversal of an impairment loss on a revalued asset is recognized in other comprehensive income and increases the revaluation surplus for that asset. However, to the extent that an impairment loss on the same revalued asset was previously recognised in profit or loss, a reversal of that impairment loss is also recognised in profit or loss. After a reversal of an impairment loss is recognised, the depreciation (amortization) charge for the asset is adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.

(ii) Indications of reversals of impairment loss (Paragraph 111 of Ind AS 36)

In assessing whether there is any indication that an impairment loss recognised in prior periods for an asset other than goodwill may no longer exist or may have decreased, an entity shall consider, as a minimum, the following indications:

External sources of information

(a) there is observable indication that the asset's value has increased significantly during the period;

(b) significant changes with a favorable effect on the entity have taken place during the period, or will take place in the near future, in the technological, market, economic or legal environment in which the entity operates or in the market to which the asset is dedicated; and

(c) market interest rates or other market rates of return on investments have decreased during the period, and those decreases are likely to affect the discount rate used in calculating the asset's value in use and increase the asset's recoverable amount materially.

Internal sources of information

(a) significant changes with a favourable effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, the asset is used or is expected to be used; and

(b) evidence is available from internal reporting that indicates that the economic performance of the asset is, or will be, better than expected.

7. A registered person is not entitled to take ITC in respect of any invoice/debit note for supply of goods or services or both after the **30th day of November following the end of financial year** to which such invoice/debit note pertains or furnishing of the relevant annual return, whichever is earlier.

Thus, in accordance with above provisions, the view taken by Sahana that ITC of missed invoices may be taken till filing GSTR 3B return for the month of March of the concerned financial year is **not correct.**

The ITC of missed invoices can be taken till 30th day of November following the end of financial year to which such invoice pertains or furnishing of the relevant annual return, whichever is earlier.

8. Different Roles of Executive and Non-Executive Directors

The Board of Directors may comprise both executive and nonexecutive directors. The executive directors are responsible for managing different business operations. A whole time director and the Managing Director are covered under this category. In contrast, the non- executive directors participate through Board Meetings in discussions relating

to formulation of policies from the efficient management of the business. Professional directors and nominee directors are included in this category. They are not as active as that of executive directors and they are held liable only if they knowingly consented for wrongful acts.

Responsibility of Independent Directors with reference to financial reporting and approval as apart of Audit Committee According to Section 177 (4), every Audit Committee shall act in accordance with the terms of reference specified in writing by the Board which shall, inter alia, include,-

(a) recommendation for appointment, remuneration and terms of appointment of auditors of the company;

(b) review and monitor the auditor's independence and performance, and effectiveness of audit process;

(c) examination of the financial statement and the auditors' report thereon;

(d) evaluation of internal financial controls and risk management systems.

(e) valuation of undertakings or assets of the Company, wherever it is necessary.

(f) approval or any subsequent modification of transactions of the company with related parties.

(g) scrutiny of inter-corporate loans and investments

(h) monitoring the end use of funds raised through public offers and related matters.

The Independent Director (ID) is a person of integrity andpossesses relevant expertise and experience in one or more fields of finance, law, management, sales, marketing, administration, research, corporate governance, technical operations or other disciplines related to the company's business. Majority of members, being an independent directors in the Audit Committee leads to promote the principles of corporate governance by enabling disclosures, transparency, and accountability of the Company.

All the afore mentioned transactions have a critical impact with reference to the financial reporting process and approval of the financial statements. Accordingly, the Independent Directors in their capacity as members of the audit committee play a key role.

CASE STUDY 10

Apara and Sampad had completed their articleship training from a reputed CA Firm in Chennai. Both were good in studies and after qualifying they decided to become partners in profession and partners in life. Sampad was proficient in interpretation of laws and direct tax, while Apara was good in indirect tax, audit and financial reporting. They started their Firm at Kochi in the name of Apara Sampad & Co., Chartered Accountants.

Currently, they have a well-established practice spread across various spheres including FEMA, Corporate law, international taxation, valuation, etc. Apara and Sampad had in the past done few engagements for Greenly Ltd. Ramnik, the Vice President (Finance) of Greenly Ltd. invited Apara and Sampad for a meeting along with Finance team, internal auditors and tax consultants of the company. As Greenly Ltd was a coveted client for the Firm, Apara and Sampad attended the meeting. During the meeting, Ramnik discussed the following points:

I. Greenly Ltd is one of the leading laundry in Delhi. For cleaning of suits, it charges ₹ 625 per suit set. The price has been derived by the laundry asunder:

a.	Cleaning Materials	₹ 37
b	Labour	₹ 180 (3 hours@ ₹ 60/-)
c.	Variable overheads	₹ 80

d. Fixed Overheads ₹ 60 (3 hours @ ₹ 20 per hour) plus mark up 75% on total cost

The Company is known for timely delivery and quality service and hence, it charges premium for its services. The labour charges have been derived by dividing the total salary paid by the total number of hours available. Variable overheads depend on the number of suits cleaned while fixed overhead rate is derived at by dividing the total cost of all related expenses by the number of labour hours available. Fixed Overhead generally includes office rent and administrative salary. A conference is being held in Delhi on account of T20 and a hotel is also required to provide premium laundry services for which the Company has been approached for its lowest quotes. There is possibility of 150 suits being given for laundry on priority basis. The Company has sufficient material of cleaning in stock even for this additional special order. It is believed that 55% of the additional work can be done in normal working hours and for

rest of the work, overtime by some of the employees will be required. Overtime hours are paid at one and one half of the normal hourly rate.

II. Greenly Ltd is having 3 years average profit of ₹ 10 Crores and during the financial year 2023-24 and it is required to spend on account of Corporate Social Responsibility (CSR). It has incurred this expenditure through an NGO named Green Foundation.

III. The Company purchased a land in city outskirts on 1st August 2018 for a consideration of ₹ 1.25 Crores to construct a factory, for which the Stamp duty valuation on that date was ₹ 1.75 Crores. Later, management decided to sell that land to fund the business diversification objectives. On 1st August 2023, the land on city outskirts was sold for ₹ 5.00 Crores. The stamp duty valuation was ₹ 5.40 Crores. Cost inflation index for F.Y. 2018-19 and F.Y. 2023-24 is 280 and 348, respectively.

IV. ABC LLP, the Statutory auditors of Greenly Ltd resigned due to personal reasons and Apara Sampad & Co. was proposed to be appointed as the subsequent auditor of the Company by the Board of Directors. This was a great opportunity for both Apara and Sampad, as they were trying to get some business from Greenly Ltd.

V. After the meeting was completed, Ramnik met Sampad and had a casual discussion with him. He told that his daughter, Sweety, was pursuing post-graduation from Standford University, USA for which he had remitted USD 50,000 i.e., ₹ 40 Lakhs for her maintenance abroad under Liberalised Remittance Scheme. Thankfully, he did not have to do any other remittance during the year.

VI. While Sampad was busy in a discussion with Ramnik, CA. Mani, the internal auditor of Greenly Ltd and a close friend of Apara approached her for a quick chat. Mani informed Apara that his practice was going good and he was appointed as statutory auditor of a listed entity. Lately, he has been busy finalising the audit letter communicating the key points of audit to those charged with Governance and audit committee.

I. Multiple Choice Questions

1. From remittance of ₹ 40 Lakhs by Ramnik, the authorised dealer is:

   (a) Not required to make any collection of tax at source.

   (b) Required to make collection of tax at source of ₹ 1.65 Lakhs.

(c) Required to make collection of tax at source of ₹ 2 Lakhs.

(d) Required to make collection of tax at source of ₹ 0.165 Lakhs.

2. The capital gain arising on sale of land at city outskirts by the Company would be

(a) ₹ 2.80 Crores

(b) ₹ 2.825 Crores

(c) ₹ 1.75 Crores

(d) ₹ 2.40 Crores

3. While drafting audit letter communicating the key points of audit to those charged with Governance and audit committee, Mani was thinking if he needs to generate a Unique Document Identification Number (UDIN):

(a) Yes, separate UDINs are to be generated for the Statutory audit report and Letter to those charged with governance.

(b) No, UDIN is required only for all Certificates, all Audit Reports and all other Audit, Assurance and Attestation functions and not for any letters etc. making communications.

(c) Yes, one single UDIN can be generated for all documents of one client. UDINs are required to be generated client wise instead of document wise.

(d) No, one single UDIN can be generated for the whole year for one engagement which may include various communications by auditor to management and those charged with Governance.

4. Which of following statement is likely to be correct regarding compliances to be made by Greenly Limited?

(a) It is required to file CSR-1 as an independent form on MCA portal.

(b) It is required to file CSR-2 as an independent form on MCA portal.

(c) It is required to file CSR-1 as an addendum to AOC-4 on MCA portal.

(d) It is required to file CSR-2 as an addendum to AOC-4 on MCA portal.

5 During the conclusion of the audit, Apara was thinking if she is required to report the fact of the resignation by the previous auditor?

(a) Yes. As per Companies (Auditors Report) Order, 2020 Apara Sampad & Co. should report the resignation of ABC LLP and state if the Firm has taken into consideration the issues or objections raised by ABC LLP.

(b) No. Since the resignation of ABC LLP is due to personal reasons, the same need not be reported in the Auditors Report.

(c) Yes. As per provisions of Section 143(3) of the Companies Act, 2013,the fact of previous auditor's resignation should be reported.

(d) Yes. The fact of previous auditors resignation should be reported asper Companies (Audit and Auditors) Rules, 2014.

II. Descriptive Questions

6. Apara wants to draw the attention of the readers of the financial statements by way of an Emphasis of Matter (EOM) paragraph in the Audit Report issued by them indicating the fact of their appointment due to resignation of the existing auditor. Explain the circumstances in which an auditor may consider to include an Emphasis of Matter (EOM) paragraph in their audit report. Is approach of Apara proper?

7. Sampad discussed with Apara and thought that it would be handy and easy to explain the clients the details of Liberalised Remittance Scheme (LRS), if they have standard document. Draft a note covering various aspects of LRS.

8. Ramnik requests you to:

(i) Compute the incremental cost of Greenly Ltd. which may be taken as a base for quoting the minimum price per suit.

(ii) Indicate the aspects to be considered for making lowest quote.

ANSWERS TO THE CASE STUDY 10

I. Answers to the Multiple Choice Questions

1. (b) Required to make collection of tax at source of ₹ 1.65 Lakhs.

Reason: Second proviso to section 206C(1G).of the Income-tax Act, 1961, requires collection of tax at source @ 5% of the amounts in excess of ₹ 7 Lakhs in a financial year. Hence, 5% of ₹ 40 Lakhs - ₹ 7 Lakhs = ₹ 1.65 Lakhs.

2. (b) ₹ 2.825 Crores

Reason: Working will be as under:

Total consideration	₹ 5.00
Indexed cost	₹ 2.175 (Stamp duty value at the time of purchase ₹ 1.75 Crores x 348/280)
Capital Gain	₹ 2.825 crores
As the variation at the time of sale is less than 110%, the actual consideration will be taken	

3. (b) No, UDIN is required only for all Certificates, all Audit Reports and all other Audit, Assurance and Attestation functions and not for any letters etc. making communications.

Reason: UDIN is required only for all Certificates, all Audit Reports and all other Audit, Assurance and Attestation functions and not for any letters etc. making communications.

4. (b) It is required to file CSR-2 as an independent form on MCA portal

Reason: CSR-2 form is mandatory for CSR reporting. It is an independent form. CSR-1 relates to registration of entities/NGOs who wish to undertake CSR activities and want to get funding from companies on this account.

5. (a) Yes. As per Companies (Auditors Report) Order, 2020 Apara Sampad & Co. should report the resignation of ABC LLP and state if the Firm has taken into consideration the issues or objections raised by ABC LLP

Reason: As per clause (xviii) of para 3 of Companies (Auditor's Report) Order 2020 Apara Sampad & Co. should report the resignation of ABC LLP and state if he has taken into consideration the issues or objections raised by ABC LLP.

II. Answers to the Descriptive Questions

6. **Emphasis of Matter paragraph** is a paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements.

Circumstances in which an auditor may consider to include an **Emphasis of Matter (EOM) Paragraph their Audit Report:** SA 706 contains specific requirements for the auditor to include Emphasis of Matter paragraphs in the auditor's report in certain circumstances.

These circumstances include:

(i) When a financial reporting framework prescribed by law or regulation would be unacceptable but for the fact that it is prescribed by law or regulation.

(ii) To alert users that the financial statements are prepared in accordance with a special purpose framework.

(iii) When facts become known to the auditor after the date of the auditor's report and the auditor provides a new or amended auditor's report (i.e., subsequent events).

(iv) An uncertainty relating to the future outcome of exceptional litigation or regulatory action.

(v) A significant subsequent event that occurs between the date of the financial statements and the date of the auditor's report.

(vi) Early application (where permitted) of a new accounting standard that has a material effect on the financial statements.

(vii) A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.

In view of above, contention or Apara, to draw the attention of the readers of the financial statements by way of an Emphasis of Matter (EOM) paragraph in the Audit Report issued by them indicating the fact of their appointment due to resignation of the existing auditor, **is not correct.**

7. Various aspect of the Liberalized Remittance Scheme (LRS)

The Liberalized Remittance Scheme (LRS) is part of the Foreign Exchange Management Act (FEMA) 1999, which lays down the guidelines for outward remittances from India.

Liberalized Remittance Scheme (LRS)

- It applies to all resident individuals, including minors.
- It allows to freely remit up to USD 250,000 per financial year (April – March).
- It can be for any permissible current or capital account transaction or a combination of both.
- This is inclusive of foreign exchange facility for the purposes mentioned in Para 1 of Schedule III of Foreign Exchange Management (CAT) Amendment Rules 2015, dated May 26, 2015.
- In case of remitter being a minor, the LRS declaration form must be countersigned by the minor's natural guardian. The Scheme is not available to corporates, partnership firms, HUF, Trusts etc.
- Remittances under the Scheme can be consolidated in respect of family members subject to individual family memberscomplying with its terms and conditions.

Exception: Clubbing is not permitted by other family members for capital account transactions such as opening a bank account/investment/purchase of property, if they are not the co-owners/co-partners of the overseas bank account/investment/property.

8. (i) 'Greenly Ltd' can use the incremental cost numbers for pricing the 'rush order'. The minimum price that firm would charge is ₹ 238.50 per suit (=₹35,775/150). This price is well below normal price of ₹ 625.

Particulars	Amount (₹)
Cleaning materials (150 × ₹37)	5,550
Labour (150 × 3 × 45% × ₹60 × 1.5)	18,225
Variable overheads (150 Suits × 80)	12,000

Incremental cost	35,775
Quote per Suit	238.5

(ii) Aspects to be considered for quoting lowest price

Firms face situations where they are confronted with the opportunity of offering for a one time special offer. In this situation, only the incremental cost of the undertaking the order should be taken into consideration. Quote should be made at prices that exceeds incremental costs.

However, in decision making other conditions are equally important. For instance, if this is a one-time deal wit**h no prospect of repeat business**, then 'Greenly Ltd' might well charge a premium over the normal price. Long-term implications also matter. The prospect of "getting a foot in the door" to quote for future business would push the price downward. Therefore, 'Greenly Ltd' can price based on both the short-run benefits from accepting the order and the long-run consequences.

CASE STUDY 11

V-Cure Limited is a pharmaceutical company that has many divisions. One of its divisions (Division A) produces chemical vials that can be used for storage of medicines. These chemical vials have both internal and external market. Division B is another department of the same company, uses these vials to package some of the medicines it produces. Following is the information regarding production at Division A:

Annual Capacity: 30,00,000 chemical vials.

Actual annual production: 25,00,000 chemical vials

Internal transfer to Division B (annual): 10,00,000 chemical vials per year.

Annual External sales: 15,00,000 chemical vials per year.

Division A incurs a variable cost of production ₹900 per vial. The fixed cost of production of Division A is ₹40 crore per year. Out of this, ₹15 crore per year on account of machinery and production infrastructure to be maintained for the internal sales to Division B. This has been procured to produce vials exactly as per the specifications of Division B. As per the company's current procurement policy, since Division A is operating at less than full capacity, Division B has to purchase its entire annual requirement from Division A. Division A charges Division B at full cost plus 1% mark up as its transfer price. This is in tune with the company's overall transfer pricing policy that is used for inter departmental transfers. Performance assessment of each departmental manager gives emphasis on the overall financial performance of the department.

Sale price of medicines manufactured by VCure Limited follows total cost based plus mark up pricing method. VCure Limited estimates the total production and total cost a few months before the start of the next financial year and determines the sale price for each of its medicines sold in the market for that year.

Recently, the manager of Division B has received a proposal from an external vendor where chemical vials can be procured for ₹1,050 per vial. The product specifications would be suitable for the requirements of Division B and hence they are comparable with the customized production that Division A makes for Division B. The manager of Division B would like to purchase vials from the external vendor.

VCure closes its books on March 31st of each year. The primary assets of Division A comprises of an equipment that is used to make the chemical vials. VCure had purchased the equipment on April 1, 2020 for ₹6,00,00,000. Useful life of the equipment is 10 years. On March 31st, 2023 the company classified this equipment as held for sale. The impairment testing provides an estimated recoverable amount of ₹4,00,00,000. The fair value less cost to sell on March 31, 2023 was ₹3,50,00,000. On March 31st, 2024 the management changed its plan to sell the equipment, so it no longer met the criteria as held for sale. The recoverable amount as at March 31st, 2024 is ₹4,50,00,000.

You are the chief financial officer (CFO) at V-Cure Ltd. The sales team, comprising of Medical Representatives (MR) has been given a target to grow the sales volume by 10% year on year. Pharmaceutical companies like V-Cure Ltd. operate under Oligopolistic market conditions. These companies, including V-Cure Ltd. use sales promotion i.e. use of incentives to encourage patronage like free samples, free trials, loyalty programs etc. as part of its marketing strategy. During the course of your service at V-Cure Ltd., you come across certain financial and non financial inducements (kickbacks) given by few of the Medical Representatives to doctors who prescribe a particular drug developed by the company. The MRs request the doctors to not to reveal certain side effects of a drug that can lead to complications in certain cases. This is done to increase the sales volume of the business, which is also used in the performance evaluation of the Medical Representatives for career promotions and advancements.

V-Cure Ltd. has undertaken a core competency analysis to find out how it can improve its value chain. In the Oligopolistic conditions, the company wants to follow product differentiation strategy.

I. Multiple Choice Questions

1. By following total cost based pricing plus mark up for products, what are the disadvantages of this policy for V-Cure Ltd.?

   (1) Does not consider if the customer is willing to pay the price arrived at based on total cost

   (2) Requires budgeting of production output volume to determine allocation of overheads, this may not always be accurate

   (3) Surplus generated from sales cannot completely cover the replacement cost of fixed assets in an inflationary economic condition

(4) Pricing using this method is difficult to arrive at due to lack of information

Options

(a) 1 and 2

(b) 1, 2 and 3

(c) 1, 3 and 4

(d) 2 and 3

2. With reference to the information provided in the case study about the Medical Representative (MR) team requesting doctors not to reveal the side effects of a drug in order to boost sales, as a senior professional accountant in service, what action will be appropriate in this situation?

(a) Ignore the information since it does not directly relate to your area of oversight as a management accountant.

(b) Ignore the information since you are not receiving the kickback personally and therefore you are not doing anything unethical.

(c) The actions of the MR team affect public health which requires you as a senior professional accountant in service to respond appropriately as per ICAI's Code of Ethics.

(d) Ignore the information since the company does not follow its own Code of Ethics that it has drafted, hence there is no obligation on you to do so.

3. Pharmaceutical companies like V-Cure Ltd. operate under Oligopolistic market conditions. Like its competitors, V-Cure Ltd. follows non-price strategy to market its products over a pricing strategy because:

(a) Pricing information is not easily available as there are many players in the market

(b) A non-price strategy cannot be easily tracked by rivals and thereby gives the firm a competitive edge

(c) Pricing strategies lead to price wars which hurt long term profitability

(d) Following a non price strategy is more cost effective compared to pricing strategy

4. Division A and Division B of V Cure Limited operate under different managers who are assessed based on the financial performance of their respective divisions. Which McKinsey 7S element does this most closely relate to?

   (a) Strategy

   (b) Structure

   (c) Systems

   (d) Shared Values

5. V-Cure Ltd. has undertaken a core competency analysis to find out how it can improve its value chain. In the Oligopolistic conditions, the company wants to follow product differentiation strategy. Which of the following parameters is not a test for core competency

   (a) Cost advantage

   (b) Difficulty in imitation by competitors

   (c) Relevance to the customer

   (d) Breadth of application in terms of the potential markets it can open up

II. Descriptive Questions

6. As a management accountant, please analyze the scenario with respect to the inter department transfer from Division A to Division B, for the following:

   1. Calculate the internal transfer price based on full cost plus 1% mark up.

   2. Discuss the pros and cons of the current transfer pricing methodology.

   3. Should the management permit Division B to procure chemical vials from the external vendor?

7. Recommend the accounting treatment of the events for the year ending March 31, 2023 and March 31, 2024 and calculate the value of the equipment at the end of 2023 and 2024.

ANSWERS TO THE CASE STUDY 11

I. Answers to the Multiple Choice Questions

1. **(b)** 1, 2 and 3

Reason: Statements 1, 2 and 3 are the disadvantages of total cost based pricing.

Statement 1 – Pricing based on total cost with an added mark-up may not always be helpful in generating demand. This method does not take into account the potential customers' preference to buy the product at the determined price.

Statement 2 – Overhead allocation is a cost used to arrive at the total cost for the product, it is allocated to each produce based on the budgeted production volume. Hence, there may be under or over recovery of overhead if the budgeted production is not accurate enough.

Statement 3 – Sale price is dependent on total cost, for which depreciation is calculated on historic prices of fixed assets. In case the cost of fixed assets remains stable, then the surplus generated using such a sale price will cover the replacement cost of the fixed asset at the end of its useful life. However, in inflationary economic conditions, the cost of fixed assets increase. Hence, the surplus generated from the sale price based on historic costs will not be sufficient to fund the replacement of the fixed asset at the end of its useful life.

Statement 4 – Total cost method is simple to follow with a defined set of steps. The company will have complete information of its costs hence there is no lack of information.

2. **(c)** The actions of the MR team affect public health which requires you as a senior professional accountant in service to respond appropriately as per ICAI's Code of Ethics.

Reason: as per IESBA, actions that affect public safety and health would fall under NOCLAR under the Revised Code of Ethics. Your response as a senior professional accountant in service, is outlined under Section 260 of NOCLAR.

3. **(c)** Pricing strategies lead to price wars which hurt long term profitability

Reason: because while determining the pricing for a product, each firm considers not just the demand for the product but also the possible reactions of other firms

to every change. A reduction in price by one firm is quickly followed by the rivals. Hence, revenue keeps getting reduced and this price war can hurt profitability. In an Oligopoly, given that there are only few firms, information is available to both the firm and its rivals, hence pricing information as well as any move done by any of the firms gets noticed by the competitors.

4. (b) Structure.

Reason: It is the formal framework by which job tasks are divided, grouped, and coordinated. It is the formal pattern of interactions and coordination designed by management to link the tasks of individuals and groups towards achieving organizational goals.

5. (a) Cost advantage

Reason: Cost advantage is not a test of core competency since V-Cure Ltd. wants to follow product differentiation strategy rather than cost leadership strategy.

II. Answers to the Descriptive Questions

6. (1) Calculation of transfer price at full cost plus 1%

Sr. No.	Cost component	Annual cost (₹)	Cost per vial (₹)
1	Variable cost per vial		900.00
2	Annual Fixed cost		
	a) Special equipment for Division B (₹150,000,000/10,00,000) Note 1	15,00,00,000	150.00
	b) Remaining fixed cost (₹250,000,000/25,00,000)	25,00,00,000	100.00
	Total fixed cost	40,00,00,000	250.00
3	Total cost per vial (1 + 2)		1,150.00
4	Mark up @1%		11.50
5	Total internal transfer price		1,161.50

Note 1: The fixed cost related to the cost of special equipment should be borne only by Division B.

They need to be spread over the number of units produced at Division B that is 10,00,000 per year.

The remaining fixed cost will be absorbed by the entire annual production that is 25,00,000 units per year, production for both the internal and external market.

2. Pros and cons of full cost plus 1% internal transfer price policy.

The full cost plus 1% internal transfer price policy is a uniform policy followed throughout V-Cure Ltd. Performance assessment of department managers is based partly on financial results.

Allowing for a 1 % mark up over full cost has the following advantages:

(a) Charging based on full cost allows the supplying division (Division A) to recoup its entire cost of production.

(b) The supplying division has an incentive to cater to internal sales since the 1% mark-up will reflect in the profits earned by the department. Financial performance is considered during the performance assessment of the manager of Division A. The mark-up on internal sales will also be perceived as a means of earning profits that can bolster the department's performance.

The problem with full cost plus mark-up costing are as follows:

The method allows the entire cost incurred by Division A to be absorbed by the total units produced by it. As per the transfer pricing policy, Division A can recoup the entire cost it incurs plus earn a 1% mark up. Thus the financial performance would always reflect a profit in the books of Division A. There is no incentive for Division A to attempt to reduce any of its cost components, either variable or the fixed costs.

Division A is not producing at its full capacity, it is currently operating at 83% of its capacity (25,00,000 units of actual production / 30,00,000 units total capacity). The total annual cost of production is ₹265 crores per year, comprising of variable cost of ₹225 crores per year (25,00,000 units of vial produced per year * ₹ 900 per vial) plus fixed cost of ₹40 crores per year.

Out of the fixed cost of ₹40 crores per year, cost specific to Division B is ₹15 crores per year absorbed by the production of vials for Division B alone. The balance ₹25 crores per year of fixed cost is absorbed by all the vials produced both internal and external sales. This component of ₹40 crore per year fixed costs (15.09% of total costs - ₹40 crore / ₹265 crore) would partly include costs related

to idle capacity, example depreciation of underutilized machinery, rental for factory building that is not completely utilized, under-utilized storage space etc. However, this cost is being passed on to both Division B and the external customers. Division A is not taking any steps to lower the fixed costs since it is able to pass on the cost and earn a mark up on it too. Therefore, there will be no attempt by Division A to keep the costs at the optimal level, that might be comparable to external market vendors of similar vials. Thus, cost-competitiveness, which is an essential part of product pricing is lost.

(3) Consideration of producing in-house versus outsourcing procurement of chemical vials for Division B.

The external vendor is offering a similar vial at ₹1,050 while Division A is charging ₹1,161.50 per vial. The cost is more by ₹111.50 per vial. Overall, for 10,00,000 vials per year, Division B pays ₹ 11.15 crores extra just to have the vials produced internally by Division A.

Keeping the long run business interest in mind, the management of V-Cure Ltd. should direct Division A to find ways of optimizing its cost and make it cost competitive with the external market. If there is no expectation that the idle capacity would utilized in the long run, Division A has to scale down its operations to only that much capacity that can be utilized optimally. The management of V-Cure Ltd. can even think of outsourcing the procurement of vials to external vendors.

While re-evaluating the transfer price with respect to the external market price, the company should also adjust the price for costs that are not typically incurred for internal sales. Adjustments may be required for a variety of costs that may be incurred at a much lower price for internal sales, namely packing costs, storage and transportation costs, administrative costs, practically no selling and distribution costs etc. Adjustment should also be made to give effect to the estimate profit margin the external vendor earns from sale of the vial at ₹1,050 per vial. Given these adjustments, the transfer price should be made competitive as compared to the external market price for a similar vial.

If Division A is able to achieve cost reduction and make it competitive as compared to the market, the management may continue its current policy of internal procurement. Otherwise, in the long run, it will be better to outsource procurement of chemical vials for Division B.

7. (a) Value of equipment immediately before the classification as held for sale as per Ind AS 16 and Ind AS 36 as on March 31st, 2023

Particulars	Amount (₹)
Purchase price of the equipment	6,00,00,000
Less: Accumulated depreciation (for 3 years, March 31st ending 2021, 2022 and 2023)	(1,80,00,000)
Less: Loss on fair valuation (Balancing figure)	20,00,000
Carrying amount on March 31, 2023	4,00,00,000

On the initial classification as held for sale on March 31, 2023, the value will be lower of:

Carrying amount ₹4,00,00,000

Fair value less cost to sell ₹ 3,50,00,000.

Hence, on March 31st, 2023 the equipment classified as held for sale will be recorded at ₹3,50,00,000. Impairment loss on initial classification as held for sale is hence ₹50,00,000.

Depreciation of ₹60,00,000 for the year and loss of ₹70,00,000 (₹20,00,000 loss before reclassification of equipment as held for sale + ₹50,00,000 impairment loss on initial classification as held for sale.)

(b) On March 31st, 2024 the equipment is reclassified as it is no longer considered as held for sale due to change of plans by the management. The value of the equipment on March 31st, 2024 will be:

Sr. No.	Particulars	Amount (₹)
a	Carrying amount immediately before classification as held for sale on March 31st, 2023	4,00,00,000
b	*Less:* depreciation based on the balance 7 years of equipment life	(57,14,286)
c	Carrying amount had the asset not been classified as held for sale	3,42,85,714
d	Recoverable amount	4,50,00,000

The equipment will be valued at ₹3,42,85,714 as on March 31st, 2024.

Adjustment to the carrying amount will be:

Carrying amount of equipment on March 31st, 2023	₹3,50,00,000
Less: Carrying amount of equipment on March 31st, 2024	₹3,42,85,714
	₹ 7,14,286

Hence, the adjustment of ₹7,14,286 will be charged to profit and loss.

CASE STUDY 12

MNO Ltd. is a renowned powerhouse in the FMCG sector, known for its wide range of household products and a robust distribution network across urban centers. Despite its strong market position, MNO Ltd. has been facing challenges in penetrating rural markets and diversifying its product portfolio to include healthier, sustainable options that are increasingly in demand.

PQR Ltd., on the other hand, is a rising star in the FMCG landscape, with a strong foothold in rural areas and an innovative line of eco-friendly, organic products. PQR Ltd.'s unique approach to utilizing local resources and its sustainable supply chain has earned it a loyal customer base and recognition for its green initiatives.

As consumer trends shift towards healthier and more sustainable products, MNO Ltd. recognizes the need to adapt its product offerings and market approach. The leadership team at MNO Ltd., led by the visionary CEO, conducts a strategic review, and identifies the acquisition of a company aligned with these emerging trends as a critical pivot for future growth.

MNO Ltd. embarks on a search for a suitable acquisition target, with PQR Ltd. quickly emerging as a frontrunner due to its innovative product line and strong rural penetration. PQR Ltd.'s practices also align with MNO Ltd.'s long-term vision of sustainability and social responsibility.

MNO Ltd decides to acquire PQR Ltd. by merger and the following data is available in respect of the companies:

	MNO Ltd.	**PQR Ltd.**
Number of equity shares	30,500	61,000
Market value per share	22	110
Earnings after tax	61,000	3,05,000

The summarised Balance Sheets of MNO Ltd. and PQR Ltd. immediately before the merger are as follows (the fair values of assets and liabilities of both the companies are same as their carrying values):

Particulars	**Amount (₹ in thousands)**	
	MNO Ltd.	**PQR Ltd.**
Current Assets	700	600

Non-Current Assets	1,100	3,000
Total Assets	**1,800**	**3,700**
Current Liabilities	495	200
Non - Current Liabilities	300	1,200
Total Liabilities	**795**	**1,400**
Equity		
30,500 Shares of 10 Each	305	-
61,000 Shares of 10 Each	-	610
Retained Earnings	700	1,690
Total Equity	**1,005**	**2,300**
Total Equity and Liability	**1,800**	**3,700**

MNO Ltd. has decided to acquire PQR Ltd. by acquiring its shares. MNO Ltd. prepared a scheme by which an offer was made to the shareholders of PQR Ltd. The Offer was made on 1st March 2023. The offer remained open for four months. Such an offer was approved by shareholders having 92% value of the shares. Subsequently MNO Ltd. gave notice to the remaining dissenting shareholders that it desires to acquire their shares. Such notice was given on August 2023. Certain dissenting shareholders made an application to the Tribunal that acquisition of their shares should not be permitted. However, their application was dismissed by the Tribunal. Hence, MNO Ltd. acquired the balance shares of 8% of the dissenting shareholders.

While other minority shareholders have reconciled to the decision of the tribunal, Mr. A, a shareholder holding 5% of the shares is furious. He believes that the growth prospects of PQR Ltd are far higher than MNO Ltd. He believes that the exchange ratio should be calculated on the basis of market value alone. He also believes that forcible acquisition of shares is a violation of his rights and amounts to oppression of minority shareholders. He feels that only he should be able to decide whether he should sell his shares. Accordingly, he wishes to approach the High Court against the decision of the Tribunal

Premerger, PQR Ltd. had a block of assets carrying 15% rate of depreciation, whose WDV as on 31.3.2023 after reducing depreciation for P.Y. 2022-23 was 4 lakhs. It purchased another asset (second-hand plant and machinery) of the same block on 01.11.2023 for 1.44 lakhs and put to use on the same day. PQR Ltd. was merged with MNO Ltd. with effect from 01.01.2024.

Post merger, the directors of PQR Ltd. are appointed 5 out of 8 positions in the combined entity's board.

Despite the acquisition, it is decided that post-merger, both MNO Ltd. and PQR Ltd. will continue to operate as independent divisions, namely – MNO division and PQR division in the merged company. This acquisition, followed by the decision to keep both companies as independent units, is seen as a strategic move that combines the strengths of both entities while preserving their unique values and operational strengths. MNO division benefits from an expanded product portfolio and entry into the growing organic market segment, while PQR division gains from the extensive distribution network and market reach of MNO, setting a path for mutual growth and market dominance in the FMCG sector.

The company shall have separate COOs for both the divisions, and it wishes to evaluate their performance. It was considering computing ROI of both the divisions for this purpose. However one of the COOs pointed out that it may be possible that divisional ROI can be increased by those actions that will reduce the overall ROI of the company, and conversely, the actions that decrease divisional ROI may make the company as a whole better off. In other words, evaluating divisional managers on the basis of ROI may not encourage goal congruence.

Accordingly, for better evaluation of performance, an alternate method of measuring performance using residual income is proposed. Following are the details regarding the same:

The overall cost of capital is 8%.

	MNO Ltd.	PQR Ltd.
Available Investment Project	25 lacs	15 lacs
Controllable Contribution	2.5 lacs	1 lac

I. Multiple Choice Questions

1. The EPS of both the companies pre-merger was:
   (a) MNO Ltd. = ₹ 5; PQR Ltd. = ₹ 2
   (b) MNO Ltd. = ₹ 2; PQR Ltd. = ₹ 5
   (c) MNO Ltd. = ₹ 1; PQR Ltd. = ₹ 1
   (d) MNO Ltd. = ₹ 0.5; PQR Ltd. = ₹ 0.2
2. PQR Ltd. wants to ensure the earnings to members are same as before the merger takes place. The exchange ratio to satisfy this condition of PQR Ltd. shall be:
   (a) 1

(b) 0.4

(c) 2.5

(d) 1.09

3. If the exchange ratio as decided in Question 2 is considered, the amount of goodwill comes out to be:

(a) ₹ 3,37,000

(b) ₹ 73,82,500

(c) ₹ 9,58,000

(d) 60,87,500

4. In the above given case, the accounting acquirer and acquiree and legal acquirer and acquiree will be:

(a) MNO Ltd. – Accounting acquirer and Legal acquirer; PQR Ltd. – Accounting acquiree and Legal acquiree

(b) MNO Ltd. – Accounting acquirer and Legal acquiree; PQR Ltd. – Accounting acquiree and Legal acquirer

(c) MNO Ltd. – Accounting acquiree and Legal acquiree; PQR Ltd. – Accounting acquirer and Legal acquirer

(d) MNO Ltd. – Accounting acquiree and Legal acquirer; PQR Ltd. – Accounting acquirer and Legal acquiree

5. The COOs of both the divisions have proposed an alternate method of measuring performance using residual income. The residual income of the divisions - MNO and PQR in the merged company will be:

(a) MNO division – ₹0.5; PQR division – (₹0.2)

(b) MNO division – ₹0.5; PQR division – ₹0.2

(c) MNO division – (₹0.2); PQR division – ₹0.5

(d) MNO division – (₹0.5); PQR division – ₹(0.2)

II. Descriptive Questions

6. Mr. A has approached you for advice regarding his concerns. He wants to know whether such forced acquisition of shares in tenable under the law. He further wants to know whether he is approaching the right forum to raise his concerns. Advise him on the said matter.

7. You are required to compute the amount of depreciation allowable under the Income-tax Act, 1961 in respect of block of assets carrying 15% rate of depreciation to MNO Ltd. & PQR Ltd. for the previous year ended on 31.03.2024.

8. Supposing the merger was carried out based on the exchange ratio suggested by Mr. A, illustrate the impact of the merger on the EPS of both companies.

ANSWERS TO THE CASE STUDY 12

I. Answers to the Multiple Choice Questions

1. (b) MNO Ltd. = ₹ 2; PQR Ltd. = ₹ 5

Reason:

MNO Ltd. = 61,000/30,500 = ₹ 2

PQR Ltd. = 3,05,000/61,000 = ₹ 5

2. (c) 2.5

Reason: Calculation of exchange ratio to ensure shareholders of PQR Ltd. to earn the same as was before merger:

Shares to be exchanged based on EPS = (5/ 2) x 61,000 = 1,52,500 shares

To check
EPS after merger = (61,000 + 3,05,000)/30,500 + 1,52,500 = ₹ 2
Total earnings in MNO Ltd. available to shareholders of PQR Ltd. = 1,52,500 x 2 = ₹ 3,05,000

The EPS before merger of PQR Ltd is ₹ 5, Thus, to ensure that Earning to members are same as before, the ratio of exchange should be 2.5 share (Premerger EPS of PQR Ltd /Post Merger EPS of PQR Ltd)for 1 share.

3. (a) ₹ 3,37,000

Reason: MNO Ltd. issues 2.5 shares in exchange for each share of PQR Ltd. All of PQR Ltd.'s shareholders exchange their shares. Therefore, MNO Ltd. issues 1,52,500 shares in exchange for all 61,000 shares of PQR Ltd. MNO Ltd. legally owns 100% of PQR Ltd.

The shareholders of PQR Ltd. own 83.33% (1,52,500/1,83,000) of the combined entity. The directors of PQR Ltd. are appointed 6 out of 8 positions in combined entity's board. In accordance with Ind AS 103, PQR Ltd. (Legal Acquiree) is the

accounting acquirer and MNO Ltd. (Legal Acquirer) is the accounting acquiree as PQR Ltd. shareholders control over combined entity.

The market value per share price of PQR Ltd.'s share is ₹ 110 per share and MNO Ltd. share price is ₹ 22 per share. If the business combination had taken place in the form of PQR Ltd. issuing additional shares to MNO Ltd.'s shareholders in exchange for their shares in MNO Ltd., PQR Ltd. would have to issue 12,200 shares (30,500 / 2.5) for the ratio of ownership interest in the combined entity to be same. (12,200 / 73,200*). Therefore, the consideration for the business combination effectively transferred by PQR Ltd. is ₹ 13,42,000 (12,200 Shares x ₹ 110).

Purchase Consideration transferred (by PQR Ltd.)	₹ 13,42,000
Fair value of Assets less Liabilities Assumed (MNO Ltd.)	(₹ 10,05,000)
Goodwill	₹ 3,37,000

*12,200 + 61,000 = 73,200 shares

4. (d) MNO Ltd. – Accounting acquiree and Legal acquirer; PQR Ltd. – Accounting acquirer and Legal acquiree

Reason: MNO Ltd. legally owns 100% of PQR Ltd.. The shareholders of PQR Ltd. own 83.33% (1,52,500/1,83,000) of the combined entity. In accordance with Ind AS 103, PQR Ltd. (Legal Acquiree) is the accounting acquirer and MNO Ltd. (Legal Acquirer) is the accounting acquiree as PQR Ltd. shareholders control over combined entity.

5. (a) MNO Ltd. – ₹ 0.5; PQR Ltd. – (₹ 0.2)

Reason:

	MNO Ltd.	PQR Ltd.
Available Investment Project	25 lacs	15 lacs
Controllable Contribution	2.5 lacs	1 lac
Overall Cost of Capital (8%)	2	1.2
Residual income	₹ 0.5	₹ (0.2)

II. Answers to the Descriptive Questions

6. In case of an amalgamation, it is possible for the transferee to acquire shares of the dissenting shareholders.

The basic requirements as to acquisition of shares mentioned in Section 235 of the Companies Act, 2013 are as follows: -

- The scheme or contract involving the transfer of shares in a company (transferor company) to another company (transferee company) has been approved by the holders of not less than 9/10th (90%) in value of the shares whose transfer is involved.
- The approval of 9/10th shareholders in value shall be received within 4 months after making of an offer in that behalf by the transferee company.
- The transferee company shall express his desire to acquire the remaining shares of dissenting shareholder in 2 months after the expiry of the said 4 months and shall give notice in the prescribed manner to any dissenting shareholder that it desires to acquire his shares. The transferee company shall be entitled as well as bound to acquire the shares of the dissenting shareholders where no application is made by any dissenting shareholders to the tribunal in 1 month of receipt of notice of acquisition of shares or where an application is made by any dissenting shareholder, but such application is dismissed by the Tribunal.

In the given case, since the application made by the dissenting shareholders has been dismissed by the Tribunal, MNO Ltd. is bound to acquire all the shares of the dissenting shareholders i.e. an entire 8% shareholding. Since A Ltd acquired 5% shareholding of the dissenting shareholders, this is valid as per Section 235 of the Companies Act, 2013. Hence, the amalgamation of PQR Ltd. by MNO Ltd. is valid.

It is not recommended that Mr. A approach any forum regarding his grievances since the Tribunal has already evaluated the merits and dismissed the application by the minority shareholders. However, if he still wishes to appeal against the order, the NCLAT not the High Court would be appropriate forum for the same.

7. Statement showing computation of depreciation allowable to MNO Ltd. & PQR Ltd. for A.Y. 2024-25

Particulars	**₹**
Opening WDV as on 1.4.2023 [i.e., WDV as on 31.3.2023 after reducing depreciation for P.Y. 2022-23	4,00,000
Addition during the P.Y. 2023-24 (used for less than 180 days)	1,44,000
Total	5,44,000
Depreciation on ₹ 4,00,000 @ 15%	60,000
Depreciation on ₹ 1,44,000 @ 7.5%	10,800
Total depreciation for the P.Y. 2023-24	70,800
Apportionment between two companies:	
PQR Ltd	
60,000 x 275/366	45,082

10,800 x 61/152	4,334
	49,416
MNO Ltd.	
60,000 x 91/366	14,918
10,800 x 91/152	6,466
	21,384

8. Supposing the merger was carried out based on the exchange ratio suggested by Mr. A, illustrate the impact of the merger on the EPS and PE ratio of both companies.

	MNO Ltd.	**PQR Ltd.**
Number of equity shares	30,500	61,000
Market value per share	22	110
Earnings after tax	61,000	3,05,000
EPS	2	5
PE ratio	11	22

Exchange ratio based on Market value per share:

₹ 110/ ₹ 22= 5 or 5 shares of MNO Ltd. for 1 share of PQR Ltd.

EPS after merger

No. of equity shares to be issued (61,000 x 5)	3,05,000
Existing equity shares outstanding	30,500
Equity shares outstanding after merger	3,35,500
Total profit (61,000 + 3,05,000)	3,66,000
EPS	1.09

Impact of merger on EPS of both the companies

	MNO Ltd.	**PQR Ltd.**
EPS after merger	₹ 1.09	₹ 5.45*
EPS before merger	₹ 2	₹ 5
	(₹ 0.91)	₹ 0.45

* ₹ 1.09 x 5 = ₹ 5.45

CASE STUDY 13

Civil Aviation Industry and Company Outlook

Aviation industry has the power to change the economic landscape of a country. Connectivity is important for generation of economic growth, trade, and tourism. Millions depend on this industry for their employment, either directly or indirectly. In the recent past, the entire industry worldwide was cripped by the COVID-19 pandemic. The years 2020 and 2021 proved to be the most trying and difficult period for all companies within this industry.

"When everything seems to be going against you, remember that the airplane takes off against the wind, not with it". Who should know better than Krishna Gupta who is the Managing Director of KG Airlines, one of India's leading airlines? The quote hangs on the wall at the entrance to KG Airlines' headquarters in Gurugram.

It has taken few years to rebound back to normal scale of business operations. With the impact of COVID-19 subsiding and the easing of travel restrictions, there has been a rebound passenger traffic.

Indian economy is being considered as one of the fastest growing economies, with projections for a GDP growth of 7% year on year. Private consumption, growing economic activity in both manufacturing and service sectors has spurred growth since 2022. Post pandemic, with the easing of restrictions on civil aviation that appetite of consumers to travel has increased manifold.

In India, the passenger traffic has increased since 2022. With rise in disposable incomes, rapid urbanisation and increase in working class population, the growth in the demand for air travel is expected to persist. Tier 2 and Tier 3 cities are also expected to play a pivotal role due to greater spread of economic activity and increasing population in these cities. The government is focussed on building and expanding modern infrastructure facilities across the country in order to support the domestic civil aviation industry. Almost 100 more new airports will be operational by 2028 giving scope for development of new regional route that can provide excellent connectivity within India. It is expected that domestic aviation requires at least 4,000 fleets within the next two decades in order to meet the anticipated growth in demand.

KG Airlines

Founded in 1996 by Krishna Gupta of KG Partners and D Gupta, KG Airlines has evolved into a significant player in the aviation industry. KG Partners holds a 59% stake in KG Airlines, while

D Gupta's Singapore company, DG Assets, owns 41%. In August 1999, KG Airlines placed a firm order for fifty A320-200 aircraft, with plans to commence operations in mid-2000. The airline received its inaugural aircraft on 10 August 2000, nearly a year after the initial order. The maiden flights connected New Delhi to Mumbai. By the close of 2022, KG Airlines boasted a fleet of 270 aircraft, and an additional 40 were acquired in December 2023, solidifying its presence in the aviation market. Presently, KG Airlines serves approximately 49 cities across 25 states, carrying a total of 90 million passengers. Traded under the symbol "KGA" on NSE, KG's Board of Directors operates from its Gurugram office. A concise overview of the Board of Directors' profiles is provided in Annexure A.

Selection of Business Model

The growth trajectory of the industry holds significant potential. Several Board meetings have taken place in the past three months to discuss the optimal strategies for expanding KG Airlines' business. During the meeting, enthusiastically, Managing Director exclaimed, *"The future abounds with enticing opportunities, catering to both full-service airlines, boasting premium offerings and employing a product differentiation strategy, and low-cost airlines, capitalizing on a cost advantage strategy."* Many business propositions for both these models were prepared, analysed, and discussed in depth.

After thorough study and deliberation, it was decided that KG Airlines had better prospects by developing as a low-cost airline. The focus for the next few years will be on the domestic civil aviation sector.

Transitioning to a new business model, KG Airlines has redefined its mission, vision, and purpose as under–

The Mission − *"KG Airlines is on a mission to provide connectivity with speed and reliability, making travel hassle free and affordable for our guests."*

The Vision − *"To be a leader in aviation by offering unmatched connectivity in and with India. Speed in and out of India with ease."*

The Purpose − *"Be our Guest, we connect you to your world."*

The airline aims to build a loyal customer base by (1) providing affordable rates, (2) on-time performance and (3) courteous and hassle-free service. These are reassurances that KG Airlines wishes to provide its customers (guests/ passengers).

Moreover, KG Airlines also envisions growth in size and scale. With 100 more airports coming up within India, KG Airlines aims to increase its fleet size by leasing aircrafts, develop more

routes and provide unmatched connectivity to its customers. The expansion project is expected to be substantial, with an initial investment of at least a few hundred crore of Indian Rupees.

Operational Challenges in the Airline Industry

The management at KG Airlines soon realizes that there are multiple roadblocks to this expansion project. Increase in fleet size, development of more routes and providing unmatched connectivity all require one key element – more aircrafts. Unfortunately, in the current global scenario due to disruptions in the supply chain, aircrafts are in short supply. Moreover, the compounding effect of rising operational costs is exerting substantial pressure on margins, and the availability of spare parts poses a significant challenge for KG Airlines.

Aircraft and spare parts availability: One of the key impacts of the pandemic has been the disruption in supply chain in aircraft manufacturing and subsequent shortage of engines worldwide. Manufacturers have been unable to keep pace with growing global demand from airline companies. Market expansion plans by operating new routes have been delayed due to unavailability of additional aircrafts. Therefore, many airlines are extending the existing leases of their current fleet in order to keep up with the operations.

Over and above this, many of the existing aircrafts have had to be grounded due to unavailability of spare parts. Therefore, there has been a shortfall in the deployment of capacity to meet customer demand on many routes.

Due to lop-sided demand-supply of aircrafts, aircraft lessors, who supply the aircrafts on lease, have been increasing the lease rental. This has increased the cost of operations substantially.

Increase in the cost of operations: Jet fuel prices have been very volatile and has been on an upward trend in the recent years. Consequently, KG Airlines regularly monitors the fuel prices and assesses their impact on profitability. But it has not taken use of financial instruments to hedge the exposure.

Another critical cost component for KG Airlines is the cost of leasing and operating aircrafts, which includes lease rental, maintenance and depreciation / amortization. As mentioned earlier, these costs are also on the rise.

In addition to fuel and aircraft-related costs, there is a high demand for pilots, as well as flight and cabin crew members. Consequently, flight crew salaries and expenses have been on the rise.

The cumulative effect of increasing operational costs, including high fuel costs, lease rentals, and personnel costs, has exerted immense pressure on operating margins.

Margins under pressure: The senior management has emphasized the necessity to pass on the increased costs to the customer. However, operating in an intensely competitive market presents a challenge, as there is a limit to how much ticket fares can be raised without losing competitiveness. This is particularly crucial for KG Airlines, which, as a low-cost carrier, has engaged in code-sharing arrangements with partner airlines on specific routes to meet the rising demand and generate profits.

Maintaining profitability in the market-driven passenger ticket fare environment requires KG Airlines to focus on driving cost efficiency. Consequently, the airline has observed a gradual depletion of its cash reserves due to these factors.

Operational Highlights of KG Airlines

Particulars	FY 2023	FY 2022
Available Seat Kilometers (ASK) (in million)	1,14,000	70,400
Revenue Passenger Kilometers (in million)	94,000	52,000
Passenger Load Factor (%)	82.45%	73.86%
Cost per Available Seat Kilometer (CASK)	4.85	4.65
Revenue per Available Seat Kilometer (RASK)	4.80	3.70
Passenger traffic	90 million	75 million
Average % of scheduled flights cancelled *	1.00%	0.45%
On Time Performance (OTP)** in %	88%	80%
Number of unresolved customer complaints	10	4

*Reasons for increase in fight cancellation were primarily on account of mechanical faults and software glitches that need to be fixed along with unavailability of spare parts. In addition to technical and commercial reasons for cancellations, flights were also cancelled due to non-availability of requisite staff, particularly pilots and cabin crew. The staff attrition rate at KG Airlines has increased from 10% in 2022 to almost 15% this year. HR exit interviews have indicated that low pay scales as compared to market rates, combined with long work hours, are the primary reason for employee attrition.

Whenever a flight is cancelled, the airline has to arrange for an alternate flight or provide a refund to the passenger. In exceptional cases, compensation may have to be paid to the passenger.

** On Time Performance (OTP) is compiled at four metro airports Mumbai, Delhi, Hyderabad, and Bangalore. For delays beyond 2 hours, airlines have to pay compensation ranging from ₹ 5,000 to ₹ 20,000 for domestic flight.

Turnaround time is the time between aircraft landing and take-off. The turnaround process is a joint effort of both the ground team and the flight crew. Besides loading and unloading of passengers, aircrafts are cleaned, inspection and maintenance work is carried out. Aircrafts are also refuelled during this time. The average turnaround time is approximately 1 hour for each aircraft. A fast turnaround time ensures that the aircraft is available for the next travel leg quickly, thereby improving asset utilization. Hence, efficiency in these operations will impact revenue generation. Faster the turnaround time of planes on the ground better the prospects for revenue generation.

At the same time, in the pursuit of fast turnaround time, it is critical not to compromise on aircraft safety. Incidents related to safety issues are taken seriously not just by the company but also by the Director General of Civil Aviation (DGCA), the regulatory authority in India. Hence, safety record is also paramount to business operations.

An analysis at KG Airlines of the recent reports for delays in turnaround time and safety incident records has indicated a shortage of technical staff to inspect, detect and report faults in aircraft. The existing staff is overworked. Hence, KG Airlines plans to hire additional 100 engineers across India who can be trained at their internal training department.

As mentioned above, the number of passengers flown by KG Airlines have grown from 75 million in 2022 to 90 million in 2023. Until now there have been only few airlines within the civil aviation industry in India. KG Airlines has managed to capture majority of the traffic in certain routes. However, with the expected potential for growth within the industry, there may be more airlines that may be able to operate in these routes. Therefore, it is very important for KG Airlines to perform efficiently and manage its routes effectively.

Fare Structure in Airline Operations

A ticket worth ₹ 10,000 is sold at 5% discount per passenger. GST rate @5% is collected on this sale. Aviation security fee is charged at ₹ 500 per passenger and user development fee is charged at ₹ 250 per passenger. Airlines collect the aviation security fee from passengers when they book their tickets. This is passed to the government. This fee is used to fund the security arrangements at airports around the country. User development fee or Passenger service fee are levied by the airline when passengers book the ticket. They are then passed onto the airport operator like the government owned Airport Authority of India (AAI) or to other private operators

who have the license to operate the airport. In return for this collection service the airline is compensated at the rate of ₹ 5 per passenger from whom these fees are recovered.

The financial statements of KG Airlines are prepared in accordance with the Indian Accounting Standards (Ind AS). This commitment to compliance is evident in the extracts extracted from 'Management's Responsibility for Financial Statements,' which are provided in Annexure-B.

Strategy

To operate as a low cost, high efficiency airline, KG Airlines has the following strategy in place:

Fleet management: The fleet will be of single type of aircraft to reduce maintenance and operational costs. Planes will be leased rather than bought outright. Economy seat will be the only seat class offered.

Building digital capabilities: Digitalize processes to make them efficient, error free and cost effective. KG Airlines already has an online booking and check in system in places. It plans to encourage passengers to utilize these tools to plan their travel. These measures will reduce reliance on human intervention and can help rationalize cost. Human resources freed up from digitalization can be used for other value adding activities. Also, commission paid to travel agents can be saved by introducing online booking services. Digitalizing processes can also aid the company's capabilities to scale up its operations in future. While the digitalization of processes brings significant benefits, scheduled maintenance activities remain crucial for ensuring the efficiency and safety of airline operations.

Ancillary services: Inflight entertainment, food and beverage will be charged extra and not included in the ticket cost. KG Airlines aims to generate additional revenue through an attractive choice of in-flight entertainment, food and beverage based on popular demand. For this, it can partner with renowned in-flight service providers as well as food and beverage suppliers who can cater to wide range of customer preferences. By charging premium rates for these ancillary services, KG Airlines can improve its revenue yield.

Managing customer loyalty: KG Airlines' management is keen on getting recognition by winning high profile awards for its various services as well as by getting above average ratings from various rating agencies. On time performance, customer satisfaction, value for money are criteria which are considered for awards and ratings.

The management has realized that value for money is partly driven by the redemption choices that customer loyalty programs offer. If passengers are allowed to redeem reward points towards another flight ticket, it takes away the opportunity to earn regular revenue. This is because, a seat in a flight has to be offered at a discounted rate while outside this program it would have

earned the regular full ticket revenue. On routes that have a high passenger traffic, this would be a source of loss of regular revenue to the airline.

At the same time attractive loyalty reward programs are the best way to build and retain customer bases. While reward points are being granted, it was found that passengers were not completely satisfied with the range of choices offered for redemption. There has been huge number of unredeemed reward points. To bring a quick churn in redemption of reward points, thereby increasing customer satisfaction, KG Airlines plans to partner with stores in the airport which can accept passenger loyalty points. The passenger can redeem points from the program at these stores and get good value for money. At the same time, KG Airlines does not compromise on avenues to earn entire ticket fare of a seat.

Workforce management: High attrition rate of 15% is impacting operations. HR exit interviews indicate long work hours, low pay scale and lesser opportunities for career growth as primary reasons for high attrition. KG Airlines plans to have tie ups with training colleges and other technical institutes where technical staff and crew members can be trained in the latest developments in aviation. This will allow for personnel growth and improve staff morale. Attractive pay package, reward and recognition programs based on performance track record is being worked out to curb attrition. Improve amenities like staff mess, transportation from work to home, recreation rooms, off-site team building events are being planned out.

Performance Measurement System

The management has recognised that, with an increase in size and scale, the need arises to develop and align resources (people, technology, and processes) to deliver on the three reassurances provided to customers, which are stated above. In the highly competitive airline industry, the top management of KG Airlines desires a comprehensive view of its business regularly. Hence, they have adopted the Balanced Scorecard to access to information in a crisp and concise manner.

Given the challenges of rising costs, decreased profit margins and other business uncertainties, the airline aims to adopt “operational efficiency and performance” as its strategic theme for the coming years. A Balanced Scorecard is being prepared to understand the current performance across the four perspectives: financial, customer, internal business processes, and learning & growth.

Annexure-A: Board of Directors

Jai Kumar, Chairman and Non-Executive Independent Director	A business leader, technocrat and academic, having worked in Australia, Europe, and Asia through a career spanning over 30 years.
Ana Maria, Non-Executive Independent Director	With more than 25 years of extensive experience, Ana holds the position of Managing Partner at a renowned law firm. Her broad and varied representation of public and private corporations, alongside other entities, before various National Courts, Tribunals, and Legal Institutions has earned her acclaim on both national and international fronts.
K. Srinath, Non-Executive Independent Director	Srinath, who founded a technology company during his early twenties, has a track record of developing numerous successful businesses. In 2021, he sold his business interests and was later invited to serve as a non-executive board member for KG in 2022.
Krishna Gupta, Promoter and Managing Director	Krishna is also the Group Managing Director of KG Partners. He holds a degree in electrical engineering from the MIT.
M. Sridharan, Non-Executive Director	Sridharan, currently serving as a Governance Consultant, brings extensive experience collaborating with government, regulatory bodies, investment institutions, and banks.
Harsh Mittal, Non-Executive Director	Harsh, is a fellow member of the Institute of Chartered Accountants of India and is a graduate in Economics from Delhi University.
Markus J., Non-Executive Director	Markus, an aviation industry veteran, with an illustrious career spanning over 36 years.
K.B. Chakraborty, Independent Director*	K.B. had a successful career as a marketing executive, serving as Marketing Director of a major quoted engineering company until he retired in 2015. K.B. is fellow of CSEP. He is also an Independent Director on the Boards of several companies.
Ravi Kishan (Retd.)	Ravi trained as a commercial pilot. He flew long-haul flights with a major airline for much of his career, before being promoted to chief pilot. He retired from flying in 2022. He was then invited to join KG's Board.

*K.B. was appointed as a casual vacancy director on 3rd September 2023. His appointment was subsequently approved by the members in the immediate next general meeting.

Annexure-B: Extracts from Management's Responsibility for Financial Statements

The Company's Board of Directors is responsible for the matters stated in section 134(5) of the Act with respect to the preparation of these individual financial statements that give a true and fair view of the financial position, financial performance, ----- in accordance with the Ind AS and other accounting principles generally accepted in India. This responsibility also includes maintenance of

adequate accounting records in accordance with the provisions of the Act for safeguarding of the assets of the company and for preventing and detecting frauds and other irregularities---- relevant to the preparation and presentation of the financial statements that give a true and fair view and are free from material misstatement, whether due to fraud or error.

I. Multiple Choice Questions

(Provide the correct option to the following questions)

1. Aircrafts operated by KG Airlines, whether owned or leased require periodic maintenance. These are high value costs. As of the reporting date, provisions need to be made for these expenses based on number of variable factors and assumptions, likely utilization of the aircraft, expected cost of these high value maintenance on a future date, condition of the aircraft engine etc. Due to the complexity and subjectivity of these conditions, auditors rely on management judgement in order to quantify the amount of provision to be made. This would be an example of which type of risk in a statutory audit:

   (a) Inherent risk

   (b) Control risk

   (c) Detection risk

   (d) Contract risk

2. The Cashier committed fraud and absconded with the proceeds. The Chief Accountant was unaware of when the fraud occurred. During the audit, the auditor failed to discover the fraud. However, after completion of the audit, the Chief Accountant discovered the fraud, and an investigation indicated that the auditor did not exercise proper skill and care, performing the work in a desultory and haphazard manner.

   Which of the following statements accurately characterize the situation and the subsequent action:

   (i) The auditor exhibited due diligence and careful conduct

   (ii) Clause (7) of Part I of Second Schedule to 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 guilty of professional misconduct based on clause (7) of Part II of the second schedule to Chartered Accountants Act, 1949

Options

(a) Only (iv)

(b) Both (ii) & (iv)

(c) Both (ii) & (iii)

(d) Both (i) & (iii)

3. KG Airlines has decided to remove of expiration date on the frequent flyer miles. It has done this to improve customer satisfaction of its flyers. Using the Kano Model, which of the following attributes of the Kano Model does this pertain to:

(a) Threshold attribute

(b) Performance attribute

(c) Reverse quality

(d) Delight attribute

4. Assuming that Mr. Stephen is eligible to be appointed as a director. In line with requirements, KG Airlines aimed to fill up the vacancy caused by resignation of Mr. K.B. Chakraborty by nominating Mr. Stephen as an Independent Director. However, Mr. Ravi Kishan, a Board Director objected, contending that Mr. Stephen lacks eligibility for the Board position due to already occupancy of a position of independent director in 3 listed entities. Evaluate Mr. Ravi's claim regarding Mr. Stephen's suitability for the position of Independent Director on the Board.

(a) Yes, contention of Mr. Ravi Kishan is correct regarding Mr. Stephen that he is ineligible to be appointed being Independent Director in already 3 listed entities. Mr. Stephen cannot be appointed in KG Airlines.

(b) No, contention of Mr. Ravi Kishan is incorrect regarding Mr. Stephen’s appointment as he eligible to be appointed in maximum twenty companies. Mr. Stephen can be appointed in KG Airlines.

(c) No, contention of Mr. Ravi Kishan is not correct regarding Mr. Stephen's appointment as he eligible to be appointed in maximum ten public companies. Mr. Stephen can be appointed in KG Airlines.

(d) No, contention of Mr. Ravi Kishan is incorrect regarding Mr. Stephen's appointment, as he eligible to be appointed in maximum seven listed entities. Mr. Stephen he can be appointed in KG Airlines.

5. Given are few parameters that need to be considered while using Porter's Five Forces Model. Match the parameter to the appropriate category of the model:

Parameter	Porter's Five Forces
a. Congestion in airports due to non-availability of parking space.	i. Threat of substitutes
b. Reduced need to travel due to remote working capabilities	ii. High supplier power
c. Low switching costs to choose between airlines	iii. Threat of new entrants
d. Favourable government policies towards investments in aviation sector	iv. High customer power

Options

(a) a- ii, b- i, c- iv and d- iii

(b) a- ii, b- iv, c- i and d- iii

(c) a- iii, b- iv, c- i and d- ii

(d) a- iii, b- iv, c- ii and d- i

II. Descriptive Questions

6. CONSTRUCT a Balanced Scorecard table for KG Airlines, identifying two goals along with corresponding performance measures for each perspective. EVALUATE the relevance of these goals and performance measures to KG Airlines.

7. On 19th October 2023 Mr. K.B. resigned after working about 45 days as a director. The Board wishes to fill up the said vacancy by appointing Mr. Stephen in the capacity of independent director in the forthcoming meeting of the Board. The Board Meeting is scheduled on 31st December 2023.

(a) ADVISE the Board, keeping in view the provisions of the Companies Act, 2013, with respect to appointment of Mr. Stephen.

(b) FIND the maximum time period within which the proposed appointment of Mr. Stephen can be made in the company.

8. To recognize ticket sales from the flights KG Airlines operates, you are required to answer the following questions:

(a) DETERMINE the transaction price of KG Airlines in the given case, as per Ind AS 115. How should it recognize revenue of tickets related to scheduled future flights?

(b) Does KG Airlines have to pay GST on airport levies like user development fee, passenger service fee, etc. collected from the passengers? Briefly DISCUSS.

(c) Does KG Airlines have to pay GST on the collection charges of ₹ 5 charged for the collection service provided by the airline to the airport operators? Briefly DISCUSS.

ANSWERS TO THE CASE STUDY 13

I. Answers to the Multiple Choice Questions

1. (a) Inherent risk.

Reason: Inherent risk is the susceptibility of an assertion to a misstatement that could be material, either individually or when aggregated with other misstatements. Provision for high value maintenance cost is dependent on complex and subjective conditions. The provision is based on the management's judgement. If any assumption or judgement is incorrect, the risk of material misstatement is high. This is an inherent risk.

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

Reason: In the given case, in the course of 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 Clause (7) of Part I of Second Schedule of 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 skepticism. 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 Chartered Accountants Act, 1949 and SA 240, it is clear that the auditor is guilty of professional misconduct.

3. (d) Delight attribute of the Kano Model.

Reason: In general, frequent flyer miles have expiration dates, before which they can be redeemed. Removal of this expiration date is something that customers/ flyers would not be expecting.

4. (d) No, contention of Mr. Ravi Kishan is incorrect regarding Mr. Stephen's appointment, as he eligible to be appointed in maximum seven listed entities. Mr. Stephen can be appointed in KG Airlines.

Reason: As per Regulation 17A of the SEBI (LODR) Regulations 2015, the directors of listed entities shall with respect to the maximum number of holding of directorships, can be at any point of time, be not more than seven listed entities. Provided that a person shall not serve as an independent director in more than seven listed entities.

Notwithstanding the above, any person who is serving as a whole time director/managing director in any listed entity shall serve as an independent director in not more than three listed entities.

5. (a) a- ii, b- i, c- iv and d- iii

Reason: Congestion in airports due to non-availability of parking space→ High supplier power.

Reduced need to travel due to remote working capabilities→ Threat of substitutes.

Low switching costs to choose between airlines→ High customer power.

Favourable government policies towards investments in aviation sector→ Threat of new entrants.

II. Answers to the Descriptive Questions

6. Balanced Scorecard Table for KG Airlines, a low-cost high efficiency airline−

Perspective	Strategic Objective	Measure	Relevance to KG Airlines
Financial Perspective	**Goal-1** To lower costs, improve cost structure, and increase asset utilization	▪ Lease Cost per annum ▪ Maintenance Cost per annum ▪ Cost per Available Seat Kilometer (CASK) ▪ Cost per Available Seat Kilometer -Ex Fuel (CASK-Ex)	Input Costs like cost of fuel, leasing and labour form a major portion of operating expenses. To ***navigate the volatility of fuel prices***, the airline must vigilantly monitor and proactively secure competitive rates for procurement, utilizing financial instruments to hedge against exposure. In pursuit of its expansion project, KG Airlines has chosen to ***lease planes, deeming it a more viable option given the airline's low cash reserves***. Nevertheless, opting for an outright purchase, although more cost-effective in the long run, involves a significant upfront expenditure or necessitates debt servicing for acquisition. CASK is currently ` 4.83 and likely to increase unless KG Airlines manages its cost structure efficiently. To achieve this efficiency, the airline is ***focusing on eliminating non-value-adding costs***. This includes standardizing seats, exploring e-commerce channels, and charging customers separately for extra amenities like in-flight entertainment. Furthermore, KG Airlines has ***standardized planes that it operates in order to reduce operational costs like maintenance costs***. KG Airlines' strategy is to win market through cost leadership. Hence, maintaining a lower cost structure is paramount importance to the airline.
	Goal-2: To boost revenue and	▪ Revenue per average seat	KG Airlines wishes to build a loyal customer base by offering affordable ticket rates priced attractively in this

	broaden revenue streams	kilometre (RASK) ▪ % revenue generated from ancillary activities ▪ % revenue generated from new routes	competitive market. This will be possible only if costs can be managed efficiently. The RASK is currently at ` 4.80, which is lower than CASK ` 4.85. This implies that the airline is not making sufficiently money to cover its costs. Therefore, the airline should ***pass on some of the increase in costs to the passenger without impacting demand***. Simultaneously, it should monitor and enhance the profitability of its current customer base. ***Route planning should be done to optimize revenue generation***. This will require KG Airlines to explore opportunities to improve revenue streams (eliminate unprofitable routes, determine new routes, markets and code sharing partners, refer internal perspective). Moreover, KG Airlines can improve the value provided to customers by ***enhancing ancillary services***, including inflight entertainment, food and beverage offerings, and the sale of mementos, among others. This would make the overall bundle more appealing and potentially increase ancillary income.
Customer Perspective	**Goal-1:** Customer retention, new customer acquisition	▪ Number of repeat customers ▪ Number of high-profile awards won/ Latest rankings ▪ Number of new customers	Implementing a robust Customer Relationship Management (CRM) system is crucial for managing the number of repeat customers. ***Attractive customer loyalty programs with different redemption options*** play a key role in retaining the customer base. Customers will be motivated to travel again with KG Airlines to earn enough points for redemption. Moreover, KG Airlines's plan to bring higher churn in redemption of reward points by partnering with airport stores is a win-win strategy to ensure customer satisfaction while maintaining profitability. In addition, ***enhancing the brand image through winning high-profile awards for various services and securing above-average ratings*** from

			rating agencies contributes to both retaining and expanding the customer base. Besides, ***offering better connectivity through route planning*** at attractive prices will help to grow market share and acquire newer customers.
	Goal-2: Customer Satisfaction	▪ Number of flights cancelled ▪ 'On time performance" (OTP) statistics ▪ Compensation for flight delays and cancellations ▪ Unresolved customer complaints	Average % of scheduled flight cancelled increased from 0.45% in 2022 to 1% in 2023. This impacts customer satisfaction. Despite this challenge, OTP statistics has shown improvement in 2023 compared to the previous year. Improving On-Time Performance is essential to enhance customer experience and satisfaction. However, it is necessary to keep compensation for flight delays and cancellations at minimum. ***Building robust capabilities in operations*** will reduce instances of cancellation and delays. Moreover, unresolved customer complaints have become important concerns that demand attention from higher management. The volume of these unresolved complaints has seen an increase in 2023. Integrating these initiatives into a holistic approach is crucial for ensuring a positive overall customer experience and satisfaction.
Internal perspective	**Goal-1:** Flight Operations (Cycle time optimization)	▪ 'On the ground' (turnaround) time ▪ No. of instances of serious lapses in flight safety ▪ Maintenance frequency rate	Fast and efficient turnaround times are critical for asset utilization to generate revenue. At the same time, flight safety is paramount to running airline operations. KG Airlines has a responsibility towards the society to ensure that safety standards are met. Given that the number of flights is likely to increase from the current number of 310 and passenger traffic is expected to rise, any incidents of flight safety concerns must be given high priority and resolved effectively. To address this, increasing capacity of on- ground technical staff by KG Airlines, such as hiring additional 100

			engineers, will help to improve flight operations.
	Goal-2: Digitalisation (to develop the online booking & check-in system)	▪ Ratio of online booking vs. booking through travel agents ▪ Percentage downtime of website	Online booking and check-in capability will improve business operations efficiencies. To ensure effectiveness, digital capabilities must be able available at all times to the customers. Therefore, downtime has to be reduced. Given that KG Airlines expects passenger traffic to grow in the coming years, ***digitalizing can help it scale up operations***. Furthermore, Digitalizing can also help ***rationalize operational costs***. This is because it frees up personnel for value additive tasks and saves commission that need to be paid to travel agents (financial perspective).
	Goal-3: Route Network Redesign	▪ Passenger Load Factor ▪ Number of Routes expected to be withdrawn (loss making) ▪ Number of New Routes ▪ % of Load for New Route ▪ Time period to break-even	To foster additional growth, the airline can redesign its network and may also ***explore potential regional routes*** and ***engage in code-sharing partnerships*** with other airlines. ***Shortage of aircrafts, high lease rental and other operational costs need to be considered*** while determining route network.
Learning & Growth	**Goal-1:** Staff Motivation and Loyalty	▪ Staff attrition rate ▪ Staff absentee rate ▪ The number of days absent per employee ▪ Employee Feedback Score	KG Airlines should allow for personal growth of employees to combat staff attrition and staff absenteeism. Staff attrition rate increased from 10% to 15% this year. To mitigate concerns related to dissatisfaction arising from prolonged work hours and a perceived low pay scale, implementing ***a diverse approach can be important***. Firstly, adopting a ***performance-based attractive pay package*** can serve as a powerful motivation, aligning financial rewards with individual and team accomplishments. Secondly, ***creating a workplace environment with ample amenities***,

			favourable to employee well-being, further contributes to job satisfaction by addressing the physical and mental aspects of the work experience. Thirdly, ***incorporating team-building exercises*** can enhance collaboration, and overall workplace synergy, helping mitigate the challenges associated with extended work hours.
	Goal-2: Functional excellence and Leadership skills	▪ Strategic Skill Ratio ▪ Number of days' training per ground crew member ▪ Number of training programs	***KG Airlines should improve and maintain its strategic skill ratio*** (a metric that quantifies the proportion of strategic skills possessed by a workforce in comparison to the entire skill set) through training and development programs. ***If ground crew are better trained or multiskilled***, they can reduce the number of minutes that the plane stays on the ground, which will result in fewer planes being required and therefore lower costs. ***Tie up with institutes for training on latest developments in aviation and other programs*** will allow for personal growth and career development. This will retain skilled high performing staff.

☞ **Two goals, each with two corresponding performance measures, are sufficient. Additional performance measures have been included to ensure comprehensive coverage across various scenarios.**

7. Section 161(4) of the Companies Act, 2013 provides that if the office of any director appointed by the company in general meeting is vacated before his term of office expires in the normal course, the resulting casual vacancy may, in default of and subject to any regulations in the articles of the company, be filled by the Board of Directors at a meeting of the Board which shall be subsequently approved by members in the immediate next general meeting.

Further, any person so appointed shall hold office only up to the date up to which the director in whose place he is appointed would have held office if it had not been vacated.

In view of the above provisions, in the given case, the appointment of Mr. K.B. Chakraborty in place of the deceased director Mr. Rai was in order. In normal course,

Mr. Mr. K.B. Chakraborty could have held his office as director up to the date to which Mr. Rai would have held the same.

However, Mr. K.B. Chakraborty resigned on 19th October 2023 and again a vacancy has arisen in the office of director owing to resign of Mr. K.B. Chakraborty who was appointed by the board and approved by members to fill up the casual vacancy resulting from Mr. Rai's demise. Vacancy arising on the Board due to vacation of office by the director appointed to fill a casual vacancy in the first place, does not create another casual vacancy as section 161 (4) clearly mentions that such vacancy is created by the vacation of office by any director appointed by the company in general meeting. Hence, the Board cannot fill the vacancy arising from the resignation of Mr. K.B. Chakraborty who was appointed to fill as a casual vacancy.

In fact, here the vacancy caused by the resignation of Mr. K.B. Chakraborty will result in an intermittent vacancy. This vacancy can be filled as per Rule 4 of the Companies (Appointment and Qualification of Directors) Rules, 2014 read with Section 149(4) of the Companies Act, 2013.

Following are the answers:

(a) Accordingly, in the light of the said provisions, the Board may however appoint Mr. Stephen as a director in any capacity either independent or non-independent, as an additional director under section 161 (1) of the Companies Act, 2013 provided the articles of association authorise the Board to do so, in which case Mr. Stephen will hold the office up to the date of the next annual general meeting or the last date on which the annual general meeting should have been held, whichever is earlier. His appointment, if required, can be regularised in the subsequent general meeting of the Company pursuant to Section 149 and other related provisions of the Act.

(b) Whereof, there is an intermittent vacancy of an independent director, it shall be filled-up by the Board at the earliest but not later than immediate next Board meeting or three months from the date of such vacancy, whichever is later.

Here, Board may fill up the vacancy caused by the resignation of Mr. K.B. Chakraborty by appointing Mr. Stephen in the capacity of an independent director within 3 months from date of vacancy (i.e., by 18th of January 2024) or immediate next Board meeting (i.e. 31st December 2023), whichever is later. Hence the

maximum time period within which the proposed appointment of Mr. Stephen can be made is, latest by 18th January 2024.

8. (a) Revenue recognition for KG Airlines will be based on Ind AS 115 "Revenue from Contracts with Customers". Paragraph 47 of Ind AS 115, inter alia states that an entity shall consider the terms of the contract and its customary business practices to determine the transaction price. The transaction price is the amount of consideration which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties. Amounts collected on behalf of third parties are not economic benefits which flow to the entity. Therefore, they are excluded from revenue.

As per Ind AS 115, each booking is a contract that the passenger enters into with KG Airlines. Passenger revenue should be recognized on flown basis i.e., when KG Airlines provides the transportation to the passenger. This is when service is rendered to the passenger. Revenue should be recognized on net of discounts given to the passengers, amount collected on behalf of third parties, applicable taxes, and airport levies such as passenger service fee, user development fee, etc., if any. Fees charged for cancellation of flight tickets are recognised as revenue on rendering of the said service.

Here, the revenue from sale of ticket that should be reflected in the Statement of profit and loss of KG Airlines would be ₹ 9,500 which would be the airfare charges of ₹ 10,000 per passenger less 5% discount given to the passenger which is ₹ 500.

Particulars	Amount (₹)
Airfare charges	10,000
Less: Discount @5%	500
Net ticket fare (revenue)	9,500
Add: GST @5% on net ticket fare	475
Add: Aviation security fee	500
Add: User development fee	250
Total amount collected from passenger	10,725

Note: Since, Goods and Service Tax (GST) @5% is payable to the government, it does not form part of revenue. Similarly, aviation security fee and user

development fee are payable to the government and airport operator respectively. Here, the airline acts only as an agent to collect the money from the passenger and pass it on to the government or the airport operator. No service is rendered by the airline to the passenger on this behalf. Therefore, no revenue should be recognized for aviation security fee or user development fee by KG Airlines.

However, since the airport operator on whose behalf the user development fee is collected, compensates KG Airlines for ₹ 5 per passenger flown, it would be recognised as revenue in the books of KG Airlines. Hence, the total revenue of ₹ 9,505 would be reflected in the Statement of profit and loss separately as 'revenue from sale of tickets' and 'other operating revenue'.

Revenue from sale of tickets that relate to scheduled future flights will be recognised as "unearned revenue", forming part of current liabilities. Depending on the facts and circumstances relating to the contract, the liability recognised represents the entity's obligation to either transfer goods or services in the future or refund the consideration received. In either case, the liability shall be measured at the amount of consideration received from the customer.

(b) Services provided by an airport operator to passengers against consideration in the form of UDF and PSF are liable to GST. PSF and UDF are levied by the airport operators but are collected by the airlines. These charges are collected by the airline as an agent of passengers and is not a consideration for any service provided by the airlines.

Thus, the amount so recovered by airlines will be excluded from the value of supplies made by the airline to its passengers. In other words, the airline shall not be liable to pay GST on the PSF and UDF (for airport services provided by airport operator), provided the airline satisfies the conditions prescribed for a pure agent under Rule 33 of the CGST Rules, 2017. It is the airport operator which is liable to pay GST on UDF and PSF.

The airline should separately indicate actual amount of PSF and UDF and GST payable on such PSF and UDF by the airport operator, in the invoice issued by airlines to its passengers.

Thus, KG Airlines is not liable to pay GST on airport levies like user development fee, passenger service fee, etc. collected from the passengers.

(c) Yes, KG Airlines is liable to pay GST on the collection charges of ₹ 5 charged for the collection service provided by the airline to the airport operators. The collection charges paid by airport operator to airlines are a consideration for the services provided by the airlines to the airport operator and KG Airlines shall be liable to pay GST on the same.

CASE STUDY 14

Para A - Home Fab Private Limited incorporated in May 2023 having its registered office in New Delhi started construction of its premises building in NOIDA by using pre-fabricated structure common and prevalent in these times and 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 in month of May 2023 in State of Uttar Pradesh.

The company had already ordered in advance import of certain new textile machinery from South Korea at a cost of about ₹ 8.65 crore. Further, previously used indigenous machinery at a cost of about ₹ 2.00 crores was also planned for installation. The company was able to bring imported as well as indigenous machinery to its premises in *NOIDA* only in 1st week of August 2023 and was able to kick start its commercial production of textile made-ups from 1st September 2023 only. The company has earned huge profits during P.Y. 2023-24.

Para B - The made ups of company got a very good response in the overseas market of USA under brand *of Home Fab* and the company had captured good chunk of export orders via *digital and online marketing platforms* beating its Chinese rivals.

The company has chosen to export on payment of IGST.

The company has achieved export turnover of ₹50 crores during year ended 31st March,2024. It has also credited duty drawback from customs authorities amounting to ₹ 2.00 crores in its statement of profit and loss for the same period. During the year ended 31st March 2024, the company has also incurred research and development expenditure of ₹ 10.00 lakhs. The financial statements of the company reflected a net profit before tax amounting to ₹ 7.50 crores. for the same period.

Para C- The inhouse staff GST team of the company was marred in confusion from the very first month of export sales regarding discharge of GST liability on payment of IGST and refund issues. The export sales had begun from October 2023 and made-ups valuing ₹ 5 crores were exported during month of October 23 carrying a GST rate of 5%. The break-up of ITC for month of October 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.

Para D-The company had imported machinery worth ₹ 8.65 crores from South Korea. The said cost was CIF Mundra port. However, the company had 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, company had also incurred ₹ 3.00 lakhs on account of freight paid to D Transport services (a proprietary concern). This proprietary concern is not registered taxpayer under GST and company has deposited IGST of ₹ 0.15 lakhs on account of reverse charge.

Further, company had paid ₹ 1.77 crore to another company providing services relating to building construction (including ₹ 27,00,000/- on account of IGST) during year 2023-24.

I. Multiple Choice Questions

1. Regarding tax liability of the said company for the month of October 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.

2. In context of the information given in Para D 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)

3. Under provisions of Companies Act, 2013, the books of accounts and records are required to be kept at registered office of the company. However, the manufacturing facilities of company are located in NOIDA in state of Uttar Pradesh. In light of above, which of the following statements is in accordance with law?

(a) The company can keep books of accounts and records at NOIDA by filing form AOC-2 within 30 days of passing board resolution.

(b) The company can keep books of accounts and records at NOIDA by filing form AOC-4 within 30 days of passing board resolution.

(c) The company can keep books of accounts and records at NOIDA by filing form AOC-5 within 7 days of passing board resolution.

(d) There is no recourse available to the company as books of accounts and records are to be kept at registered office of company.

4. Which element of McKinsey's 7S Framework is primarily illustrated by this integration of machinery?

(a) Structure

(b) Strategy

(c) Systems

(d) Skills

5. Given this scenario, in which stage of the product life cycle is Home Fab's made-up products most likely positioned?

   (a) Shakeout

   (b) Maturity

   (c) Growth

   (d) Introduction

II. Descriptive Questions

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.

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 14

I. Answers to the Multiple Choice Questions

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.

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.

3. **(c)** The company can keep books of accounts and records at NOIDA by filing form AOC-5 within 7 days of passing board resolution.

Reason: Books of accounts and records can be kept at place other than registered office of the company. The relevant form is AOC-5 which is to be filed on MCA portal in 7 days of passing board resolution.

4. (**c**) Systems

Reason: Systems refer to the processes and procedures that the company uses to get work done. Efficient integration of machinery highlights the company's operational systems enabling smooth and profitable production.

5. **(c)** Growth

Reason: Given the scenario, Home Fab's 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.

II. Answers to the Descriptive Questions

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 clause (iia) of sub-section (1) of section 32 or section 32AD or section 33AB or section 33ABA or sub-clause (ii) or sub-clause (iia) or sub-clause (iii) of sub-section (1) or sub-section (2AA) or sub-section (2AB) of section 35 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, except clause (iia) of sub-section (1) of the said section, determined in such manner as may be prescribed.

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.

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.

CASE STUDY 15

Non-governmental organizations (NGOs) are non-profit entities working independent of government. UN Department of Global Communications defines an NGO as "a not-for profit voluntary citizen's group that is organized on a local, national or international level to address issues in support of the public good. Task-oriented and made up of people with a common interest, NGOs perform a variety of services and humanitarian functions, bring citizen's concerns to governments, monitor policy and program implementation, and encourage participation of civil society stakeholders at the community level." A paper released by World Bank states that NGOs are typically value-based organizations which depend, in whole or in part, on charitable donations and voluntary service.

NGOs have become very influential and prominent in world affairs and a substantial chunk of overseas development aid is routed through NGOs. Our country also has a long history of civil society movements with organizations working in diverse fields such as health, education, community services, environment protection, sanitation, drinking water and poverty eradication. With passage of time, foreign funds began flowing to domestic NGOs in India. Although work being done by NGOs has been commendable in diverse areas, it is not without criticism. One of such criticisms relates to issue of foreign donations. It has been argued that foreign funding makes NGOs accountable to fund-providing donors and can pose risk to sovereignty of a country.

Foreign contributions in India are regulated under the Foreign Contribution (Regulation) Act, 2010 (FCRA). The objective of such a law is to regulate the acceptance and utilization of foreign contribution or foreign hospitality by certain individuals or associations or companies and to prohibit acceptance and utilization of foreign contribution or foreign hospitality for any activities detrimental to national interest and for matters connected therewith or incidental thereto.

DSB Trust is one such organization working in field of preserving ecology and environment. It has been working on environmental issues since last few years and is very vocal and prominent in raising issues. However, the trust is over-zealous in its approach and has sometimes been accused of stalling crucial development projects in guise of protecting environment. It also receives substantial foreign donations from overseas agencies, trusts and its well-wishers and such donations are main source of funding for carrying out activities of trust.

The office-bearers of trust met on 25th March, 2023 to take stock of situation arising from amendments to FCRA law and rules in recent past. One of the office bearers Mr. X lamented

about increased compliance burden and changes in manner about receiving foreign contributions. He was also worried that FCRA registration of their trust is going to expire in this year and modalities for renewing FCRA registration may have undergone change due to change in laws and rules. On closer perusal, he finds that FCRA registration of trust is going to expire on 31st December, 2023.

Another office bearer, Mrs. C who is herself an activist, pointed out that legislation has tightened noose around NGOs receiving foreign contributions making it difficult for them to undertake certain types of works and incur certain expenses due to restrictions being made more stringent in respect of utilization of foreign contributions. She is of the view that expenditure relating to writing and filing reports is directly related to trust's activity of preserving ecology and environment and may be out of purview of regulatory restrictions. However, she is unsure about her stand and its legal implications.

Mr. Y also agreed with both of them and opined that field programmes cannot be run without systems and procedures in place for supervision, management, policy design and strategy. He had heard about changes in rules relating to transfer of foreign contributions to other NGOs. About 5 years ago, the trust had transferred foreign contributions to smaller NGOs having better reach to the intended beneficiaries of program run by the trust. The office-bearers were in a fix whether foreign contributions received can be transferred to another NGO for running programmes of trust now.

During meeting, Mr. Z also chipped in. He also reminisces that there had been changes in rules pertaining to registration of charitable trusts under income tax law in recent past and new procedure of registration was complied with by trust in 2021 by filing application in Form 10A. However, he wants to be clear about modalities of renewal of registration under income tax law whenever it falls due for renewal next time. Besides, the trust is planning to sell during financial year 2023-24 an immovable property held under trust wholly for charitable purposes since last 5 years and whole of proposed net consideration is to be invested in acquiring another capital asset to be held wholly for charitable purposes.

The trust has recently appointed their new auditor and tax consultant CA Madhusudan. Mr. Z is of the view that they should consult their tax consultant in respect of these matters for necessary guidance.

CA Madhusudan has also to audit account of foreign contribution for year 2023-24 and has to certify various figures pertaining to brought forward contribution at beginning of financial year, foreign contribution received during the year, interest accrued on foreign contribution, balance of unutilized foreign contribution at end of financial year. Further, utilisation of foreign

contribution received for the purpose for which trust was registered is also required to be certified.

Besides, he is also required to express an opinion on the financial statements of trust for financial year 2023-24.

Based on above case study, answer the following questions: -

I. Multiple Choice Questions

1. Mr. X is worried that FCRA registration of trust is going to expire in year 2023 itself. Which of the following statements is most appropriate regarding renewal of registration of trust and receipt of foreign contributions under FCRA?

   (a) An application for renewal of certificate of registration may be made by trust in month of September 2023 electronically to online portal of FCRA services under Ministry of Home Affairs. Foreign contribution can only be received in an account designated as "FCRA account" to be opened in designated branch of State Bank of India at New Delhi.

   (b) An application for renewal of certificate of registration may be made by trust in month of June 2023 electronically to online portal of FCRA services under Ministry of Home Affairs. Foreign contribution can only be received in an account designated as "FCRA account" to be opened in designated branch of State Bank of India at New Delhi.

   (c) An application for renewal of certificate of registration may be made by trust in month of June,2023 electronically to online portal of FCRA services under Ministry of Finance. Foreign contribution can only be received in an account designated as "FCRA account" to be opened in any designated branch of any scheduled Bank.

   (d) An application for renewal of certificate of registration may be made by trust in month of September 2023 electronically to online portal of FCRA services under Ministry of Finance. Foreign contribution can only be received in an account designated as "FCRA account" to be opened in any designated branch of any scheduled Bank.

2. Mrs. C has put forth her view on certain expenditures. However, she is unsure about legal footing of her view and related matters described in case study. Which of following statements is correct in this regard?

   (a) Expenditure of type referred to by Mrs. C is in nature of administrative expenses. The trust cannot defray an amount in excess of 50% of such foreign contribution

received in a financial year to meet administrative expenses. However, expenses above stipulated limit may be defrayed with prior approval of Central Government.

(b) Expenditure of type referred to by Mrs. C is not in nature of administrative expenses. The trust cannot defray an amount in excess of 50% of such foreign contribution received in a financial year to meet such expenses. However, expenses above stipulated limit may be defrayed with prior approval of Central Government.

(c) Expenditure of type referred to by Mrs. C is in nature of administrative expenses. The trust cannot defray an amount in excess of 20% of such foreign contribution received in a financial year to meet administrative expenses. However, expenses above stipulated limit may be defrayed with prior approval of Central Government.

(d) Expenditure of type referred to by Mrs. C is not in nature of administrative expenses. The trust cannot defray an amount in excess of 20% of such foreign contribution received in a financial year to meet such expenses. However, expenses above stipulated limit may be defrayed with prior approval of Central Government.

3. Which of the following statements is likely to be correct regarding discussion among trust members for proposed transfer of contribution for carrying out its programme described in case study?

(a) Foreign contribution received can be transferred to another FCRA registered trust for carrying out programme of DBS Trust.

(b) Foreign contribution received can be transferred to another FCRA registered trust for carrying out programme of DBS Trust with permission of Central Government.

(c) Foreign contribution received cannot be transferred to any other person. It is immaterial whether such person is FCRA registered or not.

(d) Whole of foreign contribution received cannot be transferred to any other person. A certain percentage can be transferred to any other person. It is immaterial whether such person is FCRA registered or not.

4. Mr. Z, office bearer of trust, has approached CA Madhusudan to seek his advice regarding modalities of renewal of registration of trust under income tax law. Which of following advice rendered by CA Madhusudan is in accordance with provisions of law?

(a) The registration application is to be made in Form no.10B at least six months prior to expiry date of registration of trust. Further, copy of registration under the FCRA, 2010 is mandatory with application as DBS Trust is registered under the FCRA.

(b) The registration application is to be made in Form no.10AB at least six months prior to expiry date of registration of trust. Further, copy of registration under the

FCRA, 2010 is mandatory with application as DBS Trust is registered under the FCRA.

(c) The registration application is to be made in Form no.10AB at least six months prior to expiry date of registration of trust. However, copy of registration under the FCRA, 2010 is not mandatory while filing application for registration under income tax law as it is a separate independent registration under a different law.

(d) The registration application is to be made in Form no.10B at least six months prior to expiry date of registration of trust. However, copy of registration under the FCRA, 2010 is not mandatory while filing application for registration under income tax law as it is a separate independent registration under a different law.

5. Certification from Chartered Accountant is required by DBS Trust in respect of certain matters under the FCRA described in case study. Which of following statements is true in this context?

(a) Such certification forms part of FC-4, which is prescribed annual return. It has to be uploaded duly accompanied by a balance sheet and statement of receipt and payment certified by a Chartered Accountant. If there is no receipt/utilization of foreign contribution during the year, certificate of Chartered Accountant and audited statements of account are not required to uploaded. However, submission of a NIL return even in such a case, is mandatory.

(b) Such certification is required in FC-4, which is not an annual return. It has to be uploaded duly accompanied by a balance sheet and statement of receipt and payment certified by a Chartered Accountant. If there is no receipt/utilization of foreign contribution during the year, certificate of Chartered Accountant and audited statements of account and FC-4 are not required to uploaded.

(c) Such certification is required in FC-2, which is not an annual return. It has to be uploaded duly accompanied by a balance sheet and statement of receipt and payment certified by a Chartered Accountant. If there is no receipt/utilization of foreign contribution during the year, certificate of Chartered Accountant and audited statements of account and FC-2 are not required to uploaded.

(d) Such certification forms part of FC-2, which is prescribed annual return. It has to be uploaded duly accompanied by a balance sheet and statement of receipt and payment certified by a Chartered Accountant. If there is no receipt/utilization of foreign contribution during the year, certificate of Chartered Accountant and audited statements of account are not required to uploaded. However, submission of a NIL return even in such a case, is mandatory.

II. Descriptive Questions

6. Certain matters have been highlighted in case study which may have ramifications for renewal of registration of trust under the FCRA. At the time of applying for renewal of registration of a person under the FCRA, 2010, Central Government is empowered to make inquiry in respect of wide range of matters. Discuss those matters. Do matters highlighted in case study fall among such matters?

7. (a) On the basis of overall description of case study, what factors should be considered by CA Madhusudan while assessing audit risk of DBS Trust during course of audit for financial year 2023-24?

   (b) Assume that during course of audit, CA Madhusudan suspects that there may be non-compliance by NGO in relation to some aspects of FCRA, 2010. How he should proceed in such a situation?

8. What should be proper advice of CA Madhusudan to Mr. Z regarding implications of proposed sale of a capital asset and acquisition of another capital asset as described in case study?

ANSWERS TO THE CASE STUDY 15

I. Answers to the Multiple Choice Questions

1. (b) An application for renewal of certificate of registration may be made by trust in month of June 2023 electronically to online portal of FCRA services under Ministry of Home Affairs. Foreign contribution can only be received in an account designated as "FCRA account" to be opened in designated branch of State Bank of India at New Delhi.

Reason: Under Rule 12 of the FCRA Registration rules, an application for renewal of certificate of registration shall be made to Central Government in electronic form in form FC-3C within six months before the date of expiry of the certificate of registration. FCRA is administered by Union Ministry of Home Affairs. Therefore, application for registration of trust may be made in month of June, 2023.

Further under section 17(1) of the FCRA, 2010, every person who has been granted certificate or prior permission under section 12, shall receive foreign contribution only in an account designated as "FCRA Account" by bank, which shall be opened by him for the purpose of remittances of foreign contribution in such branch of State Bank of India, New Delhi, as Central Government may, by notification, specify in this behalf.

2. **(c)** Expenditure of type referred to by Mrs. C is in nature of administrative expenses. The trust cannot defray an amount in excess of 20% of such foreign contribution received in a financial year to meet administrative expenses. However, expenses above stipulated limit may be defrayed with prior approval of Central Government.

Reason: Section 8 of the FCRA stipulates that every person who is granted a certificate or given prior permission to receive foreign contributions shall utilize such contribution for the purposes for which the contribution has been received. It further provides that such person shall not defray as far as possible such sum, not exceeding 20% of such contribution received in a financial year to meet administrative expenses. It further states that administrative expenses exceeding 20% of such contribution may be defrayed with prior approval of Central Government. Rule 5 of FCRA rules states that cost of writing and filing reports is in nature of administrative expenses.

3. **(c)** Foreign contribution received cannot be transferred to any other person. It is immaterial whether such person is FCRA registered or not.

Reason: Section 7 of the FCRA states that no person who is registered and granted a certificate or has obtained prior permission under this Act and receives any foreign contribution shall transfer such foreign contribution to any other person. Keeping in view above, it is clear that foreign contribution received by DBS Trust cannot be transferred to any other person. It is immaterial whether such person is FCRA registered or not.

4. **(b)** The registration application is to be made in Form no.10AB at least six months prior to expiry date of registration of trust. Further, copy of registration under the FCRA, 2010 is mandatory with application as DBS Trust is registered under the FCRA.

Reason: It is clear from case study that trust had complied with changed requirements of registration in 2021 and had registered itself under section 12AB of the Income Tax Act, 1961. In accordance with section 12A(1)(ac)(ii), where trust is registered under section 12AB, it shall make an application to Principal Commissioner or Commissioner at least six months prior when said registration is due to expire.

Rule 17A states that application made under section 12A(1)(ac)(ii) shall be in Form No.10AB. It also requires that applications shall be accompanied by self-certified copy of registration under the FCRA, 2010, if the applicant is registered under the Act.

5. **(a)** Such certification forms part of FC-4, which is prescribed annual return. It has to be uploaded duly accompanied by a balance sheet and statement of receipt and payment certified by a Chartered Accountant. If there is no receipt/utilization of

foreign contribution during the year, certificate of Chartered Accountant and audited statements of account are not required to uploaded. However, submission of a NIL return even in such a case, is mandatory.

Reason: Under the FCRA Rules, every person who receives foreign contribution under the Act is required to submit a report in Form FC-4 accompanied by income and expenditure statement, receipt and payment account and balance sheet for every financial year within 9 months of closure of financial year. Under the rules, FC-4 is an annual return. Submission of a NIL return, even if there is no receipt/utilization of foreign contribution during the year, is mandatory. However, in such case, certificate from Chartered Accountant and audited statement of accounts is not required to be uploaded.

II. Answers to the Descriptive Questions

6. The Central Government may, before renewing the certificate, make such inquiry, as it deems fit, to satisfy itself that such person has fulfilled all conditions specified in Section 12(4) of the FCRA, 2010. The conditions are as under: -

(a) The person making such application: -

i. is not fictitious or benami

ii. has not been prosecuted or convicted for indulging in activities aimed at conversion through inducement or force, either directly or indirectly, from one religious faith to another

iii. has not been prosecuted or convicted for creating communal tension or disharmony in any specified district or any other part of the country.

iv. has not been found guilty of diversion or mis-utilisation of its funds

v. is not engaged or likely to engage in propagation of sedition or advocate violent methods to achieve its ends

vi. is not likely to use the foreign contribution for personal gains or divert it for undesirable purposes

vii. has not contravened any of the provisions of this Act

viii. has not been prohibited from accepting foreign contribution

(b) the person making an application has undertaken reasonable activity in its chosen field for the benefit of the society for which the foreign contribution is proposed to be utilized.

(c) the person making an application has prepared a reasonable project for the benefit of the society for which the foreign contribution is proposed to be utilized.

(d) the person being an individual, such individual has neither been convicted under any law for the time being in force nor any prosecution for any offence is pending against him.

(e) the person being other than an individual, any of its directors or office bearers has neither been convicted under any law for the time being in force nor any prosecution for any offence is pending against him.

(f) the acceptance of foreign contribution by the association/ person is not likely to affect prejudicially

i. the sovereignty and integrity of India

ii. the security, strategic, scientific or economic interest of the State

iii. the public interest

iv. freedom or fairness of election to any Legislature,

v. friendly relation with any foreign State

vi. harmony between religious, racial, social, linguistic, regional groups, castes or communities.

(g) the acceptance of foreign contribution

i. shall not lead to incitement of an offence

ii. shall not endanger the life or physical safety of any person.

The matters highlighted in case study pertain to an environmental agitation turning violent. There are also allegations of using foreign contributions by a trust member for personal jaunts which is in nature of personal gains. Central Government has power to make inquiry in respect of such matters as discussed above.

7. (a) For assessing audit risk, the auditor shall consider and examine all components of audit risk. DBS Trust is in receipt of substantial foreign contributions. It may make transactions inherently risky. The credibility and integrity of persons behind NGO is important.

Shady NGOs can be involved in money laundering activities or in mis-utilizing funds received from donors. Besides, trust is over-zealous in in its approach and has been accused of stalling development projects. The auditor needs to assess whether trust continues to comply with conditions for registration under the FCRA. Non-compliance with provisions of the FCRA can make activities of NGO risky. It can have serious implications for the trust as it could lead to cancellation of FCRA certificate and other regulatory consequences. Drying up of foreign donations due to cancellation of FCRA certificate can hamper its activities badly as such donations are its main source of funding. Therefore, it requires proper assessment

of control risk that control systems and procedures are operating effectively to comply with provisions of the FCRA.

The auditor is conducting audit of trust for the first time. Therefore, it may lead to higher detection risk due to inappropriate sampling procedures or faulty application of audit procedures.

(b) In accordance with SA 250, if the auditor suspects there may be non-compliance, the auditor shall discuss the matter with management and, where appropriate, those charged with governance.

If management or, as appropriate, those charged with governance do not provide sufficient information that supports that the entity is in compliance with laws and regulations and, in the auditor's judgment, the effect of the suspected non-compliance may be material to the financial statements, the auditor shall consider the need to obtain legal advice.

If sufficient information about suspected non-compliance cannot be obtained, the auditor shall evaluate the effect of the lack of sufficient appropriate audit evidence on the auditor's opinion.

The auditor shall evaluate the implications of non-compliance in relation to other aspects of the audit, including the auditor's risk assessment and the reliability of written representations, and take appropriate action.

8. Under provisions of section 11(1A), where a capital asset, being property held under trust wholly for charitable or religious purposes, is transferred and the whole or any part of the net consideration is utilised for acquiring another capital asset to be so held, then, the capital gain arising from the transfer shall be deemed to have been applied to charitable or religious purposes to the extent specified hereunder, namely: —

(i) where the whole of the net consideration is utilised in acquiring the new capital asset, the whole of such capital gain

(ii) where only a part of the net consideration is utilised for acquiring the new capital asset, so much of such capital gain as is equal to the amount, if any, by which the amount so utilised exceeds the cost of the transferred asset

In the given case, since whole of proposed net consideration is to be utilized in acquiring new capital asset to be so held, the whole of the capital gain arising from proposed sale shall be deemed to have been applied for charitable purposes.

CASE STUDY 16

PurchaseOnn Inc. was founded in 1992 by Rose Lee as an online bookstore. It has undergone a remarkable transformation into one of the world's leading technology companies. It was initially selling books only, PurchaseOnn expanded its offerings to include music, movies, and a wide range of consumer goods like books, electronics, clothing, household goods and many more.

It launched PurchaseOnn.com in 1995 as an online bookstore, offering millions of titles for sale. It achieved significant sales within the first month of operation, reaching customers across all 50 U.S. states and 45 countries worldwide. It earned Revenue of $13.8 million in 1996, primarily from book sales in the U.S. PurchaseOnn, has continuously innovated and introduced numerous new technologies to improve its operations, enhance customer experience, and expand its business. Now, PurchaseOnn is very popular and often "the only marketplace" that people use.

Its diversification and innovations are done by expanding its product offerings beyond books to include music, movies, and eventually a wide range of consumer goods. The company introduced Jinglee E-reader in 2007 and Milee voice assistant in 2017, pioneering new consumer technologies. It also ventured into cloud computing with PurchaseOnn Web Services (PWS) in 2007, despite initial scepticism, leading to substantial revenue growth and profitability. The company successfully navigated and adapted changes caused due to economic downturns such as the dot-com crash in 2001 and the recession in 2008-2009. Though it maintained focus on long-term customer experience and innovation while streamlining costs and investing in key business areas like PWS. Its strategic investments for future growth are expansion of PWS and advertising business - providing advertisement services to other companies in the form of ads or sponsored products.

It undertook a comprehensive review of business initiatives to prioritize long-term revenue and profitability. Its recent strategy shifts are towards Closure of physical store concepts to online webstore. It also emphasised on optimizing fulfilment center and transportation network to meet surging demand during the pandemic.

Launch of PurchaseOnn business in 2016 catered to business procurement needs and drove $40 billion in annualized gross sales. It also uses advertising to promote its products and services. This includes ads in online and offline media as well as social media advertising.

It ventures into new frontiers by entry into healthcare with PurchaseOnn Pharmacy in 2021, followed by the acquisition of One Medical in 2022 to revolutionize primary care and launch of Juiper Satellite internet project to provide affordable broadband access to underserved areas,

showcasing technological innovation and social impact. It has a focus on long-term innovation, for this it made investment in Large Language Models and Generative AI to enhance customer experiences across all business segments and democratization of Generative AI technology through PWS, enabling companies of all sizes to leverage advanced machine learning capabilities. Its technology offers various functions and tools to make shopping easier for users, such as personalized recommendations and search filter options. It also offers mobile apps that allow users to purchase products through their smartphones and tablets.

PurchaseOnn.com diversified incomes are through various streams, including product sales, subscription services (Frame, Jinglee Unlimited), advertising, and cloud computing services that provide stability and resilience against market fluctuations.

PurchaseOnn.com's activities revolve around product sourcing, logistics, technology development, and customer service. Investments in fulfilment centres, delivery infrastructure, owning warehouses, logistics centres and automation technologies have enabled PurchaseOnn to streamline operations and offer faster, more reliable service to customers worldwide. The company offers a range of delivery options, including standard shipping, express shipping, and same-day delivery depending on the customer's location and the product being purchased. It also offers delivery at a shipping address that may be different than the billing address; they also offer contactless delivery, and the buyer is free to select the time frame within which delivery shall be attempted. It offers goods/ services at lower prices in comparison to other company websites and traditional retailers due to lower costs for rent and personnel. It also provides free delivery services and access to streaming services to the customers upgraded by becoming members after paying subscription fees to "Buy with Frame" annually, quarterly or monthly. In addition to free delivery, it also encourages customers to leave reviews and feedback on products and delivery services to improve its products and services. It also operates a customer service that is available via email, phone, or live chat. Customers can contact customer service if they have questions or problems, or if they need any assistance regarding PurchaseOnn products or services.

PurchaseOnn's resources include its extensive fulfilment network, proprietary technology platforms (PurchaseOnn.com, PWS, Millee), data analytics capabilities, and talented workforce. These resources serve as the foundation for PurchaseOnn's competitive advantage and innovation-driven growth.

PurchaseOnn.com forged strategic partnerships with publishers, suppliers, third-party sellers, and technology providers to expand its product catalogue, enhance its platform's functionality, and improve operational efficiency. They also entered partnerships with courier service centres,

freight forwarders and logistics centres that help it to ship products to customers. It also entered venture with Online payment service providers such as PayPayer and credit card companies to enable customers to conveniently and securely pay for their purchases.

Its expenses are related to fulfilment of technology development, marketing, and content acquisition. While investments in infrastructure and technology initially resulted in operating losses, PurchaseOnn's scale and efficiency improvements have led to profitability in its core e-commerce and cloud computing businesses.

PurchaseOnn.com policies prioritize personalized recommendations, responsive customer support, and hassle-free return policies. Its data-driven approach enables the company to anticipate customer needs and deliver tailored experiences that foster long-term loyalty and satisfaction.

PurchaseOnn.com operates a marketplace platform that allows third-party sellers to list and sell products on its website. It collects fees from these sellers for services such as fulfillment, advertising, and referral commissions. It also uses email marketing to send users personalized offers and recommendations and to inform them about new products and services. Revenue from third-party seller services includes fees, commissions, and other charges associated with facilitating transactions on the platform.

Particulars Related with Indian Subsidiary

PurchaseOnn Inc. also owns online space for advertisement on internet and has agreed to sell such online advertising space to Indian Subsidiary for an amount of ₹ 5 crores per month (USD 5,99,000). Indian Subsidiary sells such advertising space to its customers in India on its own account. The contractual arrangement for sale of such advertising space is between the customer and Indian Subsidiary.

Recently, PurchaseOnn has injected ₹ 1,000 crores into its Indian Subsidiary. This investment aligns with the projected growth trajectory of India's e-commerce sector, anticipated to reach USD 200-230 billion by 2030, with a steady annual rise of 20-22 per cent. Earlier in February 2023, the US-based parent company allocated ₹ 830 crore into its Indian entity.

On 1st April 2023, Indian Subsidiary purchased an office block (building) for ₹ 50,00,000 and paid a non-refundable property transfer tax and direct legal cost of ₹ 2,50,000 and ₹ 50,000 respectively while acquiring the building in Bangalore. During 2023, it redeveloped the building into a two -story building. Expenditures on re-development were ₹ 1,00,000 for Building plan approval; ₹ 10,00,000 construction costs (including ₹ 60,000 refundable purchase taxes); and ₹ 40,000 due to abnormal wastage of material and labour. The re-development of the building

was completed on 1st October 2023, the entity rents out Ground Floor of the building to its 100% subsidiary Rupee-Onn under an operating lease in return for rental payment. The subsidiary uses the building as a retail outlet for its operations. The entity kept first floor for its own administration and maintenance staff usage. Equal value can be attributed to each floor.

During the previous year, Indian Subsidiary has launched a new range of in – house products with its long experience in clothes and accessories section. In order to promote its in - house brand products, PurchaseOnn distributed gift vouchers to 100 lucky members worth ₹ 5,000 each on 31st January,2024. This coupon can be redeemed against any purchases of in - house brand products made in future on PurchaseOnn.

I. Multiple Choice Questions

1. Which of the following statements best describes PurchaseOnn's value proposition based on the provided information?

   (a) PurchaseOnn's value proposition lies in its diverse revenue streams, including product sales, subscription services, advertising, and cloud computing, providing stability against market fluctuations.

   (b) PurchaseOnn's value proposition centers around its key activities, such as product sourcing, logistics, technology development, and customer service, enabling streamlined operations and faster service delivery.

   (c) PurchaseOnn's value proposition is built on its extensive fulfilment network, proprietary technology platforms, data analytics capabilities, and talented workforce, serving as the foundation for competitive advantage and innovation-driven growth.

   (d) PurchaseOnn's value proposition focuses on prioritizing customer relationships through personalized recommendations, responsive customer support, and hassle-free return policies, anticipating customer needs and fostering long-term loyalty and satisfaction.

2. In the context of PurchaseOnn's evolution from an online bookstore to a global technology leader, which of the following statements best illustrates the concept of business integration?

   (a) PurchaseOnn's revenue diversification strategy, including expansion into cloud computing, healthcare, and satellite internet, showcases its ability to adapt to changing market trends.

   (b) PurchaseOnn's investment in fulfillment centers, delivery infrastructure, and automation technologies reflects its commitment to streamlining operations and offering reliable service to customers worldwide.

(c) PurchaseOnn's emphasis on personalized recommendations, responsive customer support, and hassle-free return policies demonstrates its dedication to prioritizing customer relationships and enhancing satisfaction.

(d) PurchaseOnn's expansion of PurchaseOnn Business in 2015, catering to business procurement needs, exemplifies its efforts to diversify revenue streams and capture new market segments.

3. Select which of the statement is correct in connection with Supply of vouchers in hands of PurchaseOnn to its members -

(a) Taxable supply of Rs. 5,00,000 liable to GST in the month of January.

(b) Taxable supply of Rs. 5,00,000 liable to GST in the month in which voucher is redeemed by its member.

(c) Discount offered to members on the purchases made in the month of January and no tax would be payable on such voucher.

(d) Discount offered to member at the time of redemption of voucher and no tax is payable on such voucher

4. How does PurchaseOnn's practice of allowing customers to select their preferred delivery time frame contribute to its strategic cost management?

(a) By reducing shipping costs

(b) By optimizing warehouse utilization

(c) By minimizing inventory holding costs

(d) By increasing customer satisfaction and loyalty

5. Select the correct statement specifically in relation to sale of online advertisement space service provided by PurchaseOnn Inc. to Indian Subsidiary:

(a) PurchaseOnn Inc. is providing online information and database access or retrieval service and is thus, required to register in India under GST and discharge GST on forward charge basis.

(b) PurchaseOnn Inc. is providing online information and database access or retrieval service electronically and place of supply in such case is the location of supplier which is outside taxable territory in present scenario. Therefore, no GST is payable on such services.

(c) PurchaseOnn Inc. is providing online information and database access or retrieval service and tax on the same is to be paid by Indian Subsidiary on reverse charge basis.

(d) PurchaseOnn Inc. is providing online information and database access or retrieval service and tax on the same is to be paid by Indian Subsidiary in capacity of an agent of PurchaseOnn Inc.

II. Descriptive Questions

6. Given the context, IDENTIFY and APPLY the business strategic framework applicable to PurchaseOnn.com that effectively manages its resources, aligns its activities with customer needs, generates value for both customers and stakeholders, and positions the company for continued growth and success in the dynamic global marketplace.

7. DISCUSS how the Bangalore building will be shown in the consolidated financial statements of the Indian Subsidiary and in its standalone financial statements according to the relevant Indian Accounting Standards (Ind AS).

ANSWERS TO THE CASE STUDY 16

I. Answers to the Multiple Choice Questions

1. (d) PurchaseOnn's value proposition focuses on prioritizing customer relationships through personalized recommendations, responsive customer support, and hassle-free return policies, anticipating customer needs and fostering long-term loyalty and satisfaction.

Reason: PurchaseOnn's value proposition is primarily centered around delivering exceptional customer experiences. The company emphasizes personalized recommendations, responsive customer support, and hassle-free return policies, all of which contribute to customer satisfaction and loyalty. PurchaseOnn's data-driven approach enables it to anticipate customer needs and deliver tailored experiences, enhancing the overall value proposition for its customers. This customer-centric approach is crucial for sustaining long-term relationships and driving repeat business, ultimately contributing to PurchaseOnn's growth and success in the marketplace.

2. **(a)** PurchaseOnn's revenue diversification strategy, including expansion into cloud computing, healthcare, and satellite internet, showcases its ability to adapt to changing market trends.

Reason: Business integration involves the coordination of processes, systems, and functions across various departments or entities within an organization to achieve common goals. In the case of PurchaseOnn, its evolution from an online bookstore to a global technology leader involves integrating diverse business segments and activities to drive growth and innovation.

Option A best illustrates the concept of business integration as it highlights PurchaseOnn's strategy of diversifying its revenue streams by expanding into new business segments such as cloud computing, healthcare, and satellite internet. This expansion requires coordination across different departments and functions within the organization, including research and development, marketing, and sales. By integrating these diverse business segments, PurchaseOnn demonstrates its ability to adapt to changing market trends and capitalize on emerging opportunities for growth and expansion.

3. **(b)** Taxable supply of ₹ 5,00,000 liable to GST in the month in which voucher is redeemed by its member.

Reason: As the supply against which the coupon will be redeemed is not known on the date of the sale of the coupon, the time of supply of the coupon will be the date on which the member redeems it against inhouse product of PurchaseOnn.

4. **(d)** By increasing customer satisfaction and loyalty.

Reason: Allowing customers to select their preferred delivery time frame enhances their overall experience with PurchaseOnn, fostering loyalty and repeat purchases, which in turn contributes to the company's strategic cost management by maximizing customer lifetime value.

5. **(c)** PurchaseOnn Inc. is providing online information and database access or retrieval service and tax on the same is to be paid by India subsidiary on reverse charge basis.

Reason: Sale of online advertisement space is covered under the purview of OIDAR services as per Section 2(17) of the IGST Act, 2017. However, the service provider located outside India in case of OIDAR services is required to get registered under GST and discharge tax in India under forward charge basis only if the services are provided to non-registered online recipient.

In the present case, sale of advertisement space is made by PurchaseOnn Inc. to Indian Subsidiary on principal to principal basis and Indian Subsidiary is a registered entity in India under GST. Hence, even if the services are in the nature of OIDAR service, the GST on such services is to be paid by Indian Subsidiary under reverse charge mechanism.

II. Answers to the Descriptive Questions

6. PurchaseOnn follows the Business Model Canvas framework to structure its operations and drive growth in various business segments. It aligns with each component of the Business Model Canvas and followed a systematic approach to create a successful business model, encompassing nine key steps:

CUSTOMER SEGMENTS

The key customer segments for PurchaseOnn are diverse and comprehensive.

Individual customers, the classic users of the platform, buy goods from the web-shop, benefiting from a wide range of products in various categories, such as clothes, books, and electronic items. PurchaseOnn also serves ***small businesses, including retailers, manufacturers, and wholesalers***, that want to sell their products on the platform. Additionally, PurchaseOnn has connections with ***publishers and media companies*** to sell content like books, magazines, and movies through its platform.

By catering to these diverse segments, PurchaseOnn creates a versatile marketplace that meets the needs of individual consumers, small businesses, large enterprises, and content providers.

KEY PARTNERS

Key partners for PurchaseOnn include suppliers and channel partners who play a crucial role in making the business model work.

The most important partners of the brand are those who generate the first source of revenue i.e., ***Sellers*** (suppliers or the major retail companies). ***Logistic partners***, including various logistics companies, freight forwarders, courier service centres, and fulfilment centres, ensure quick and reliable delivery of products to customers. ***Payment partners***, such as PayPayer and credit card companies, enable customers to conveniently and securely pay for their purchases. Additionally, PurchaseOnn operates a cloud computing platform called PurchaseOnn Web Services (PWS), which provides businesses with access to server capacity and other resources. PWS collaborates with various partners to provide these essential resources. Furthermore, ***independent authors*** can publish their works through Direct Publishing, allowing PurchaseOnn to offer a diverse range of content.

This collaboration enhances the overall service offering and reliability of the platform, ensuring a comprehensive and efficient experience for all users.

KEY ACTIVITIES

Key activities describe the most important things to do in a business or to keep it running smoothly. PurchaseOnn focuses on several key activities to ensure smooth operations and maintain its position in the market.

Firstly, the ***Sale of Products*** is fundamental, involving both its own products and third-party offerings. This requires not only listing products on its online platform but also ensuring they reach customers efficiently. Therefore, ***Logistics and Delivery*** are critical, with an extensive infrastructure that includes warehouses, fulfilment centres, and logistics centres, supported by partnerships with freight forwarders and courier services to ensure quick and reliable delivery. ***Marketing*** is another crucial activity, as

PurchaseOnn employs strategies to strengthen its brand, including advertising on its website and social media, providing personalized recommendations, and encouraging customer reviews. ***Customer Service*** is essential, with support available via email, phone, or live chat to assist customers with inquiries, problems, or help in using PurchaseOnn's products or services. Additionally, ***Advanced Technology and IT infrastructure*** play a vital role in enhancing website functionality, user experience, and optimizing delivery and logistics services.

These combined efforts are integral to keeping PurchaseOnn running smoothly and maintaining its competitive edge.

VALUE PROPOSITION

PurchaseOnn's **value proposition** is compelling, offering a range of benefits that set it apart from competitors and attract customers to its platform.

Firstly, ***convenience*** plays a significant role, as customers can shop from the comfort of their homes using a computer, tablet, or phone, with products delivered quickly and reliably. Moreover, PurchaseOnn boasts a ***vast selection of products***, spanning categories like books, electronics, clothing, and household goods, catering to diverse customer preferences. ***Cost efficiency*** is another key advantage, as the company's online model allows for lower prices compared to traditional retailers, supplemented by the benefits of Frame membership, which includes free shipping. Additionally, PurchaseOnn prioritizes ***fast delivery***, offering various shipping options to accommodate different customer needs, from standard to same-day delivery. Furthermore, the company's commitment to ***customer satisfaction*** is evident through its responsive customer support and hassle-free return policies, strengthening its value proposition and fostering long-term customer relationships.

In conclusion, PurchaseOnn's value proposition encompasses convenience, extensive product selection, cost efficiency, fast delivery, and customer-centric policies. These factors collectively contribute to its appeal among customers, distinguishing it as a preferred choice over competitors.

CHANNELS

PurchaseOnn utilizes various **channels** to deliver its products and services to customers effectively.

Firstly, it leverages its ***web-shop***, providing users with a platform to purchase products and offering convenient features like personalized recommendations and search filter options to enhance the shopping experience. Additionally, PurchaseOnn extends its reach through ***mobile apps***, enabling users to make purchases conveniently from their smartphones and tablets. Moreover, partnerships play a significant role, as PurchaseOnn collaborates with other companies to expand its product availability and distribution

network. These partnerships include ***agreements with retailers*** to sell PurchaseOnn's products in their stores and with logistics companies to facilitate efficient product shipment to customers.

Collectively, these channels contribute to PurchaseOnn's comprehensive distribution strategy, ensuring broad reach.

CUSTOMER RELATIONSHIP

Customer Relationship Management is essential for PurchaseOnn to acquire, retain, and grow its customer base. The company employs various strategies to enhance customer interactions and satisfaction. One such strategy is ***personalized recommendations***, where PurchaseOnn utilizes customer data to create tailored product suggestions for each individual. These recommendations are prominently featured on the website and also sent to customers via email, allowing them to discover new products that align with their preferences and interests. Additionally, PurchaseOnn actively encourages customers to ***leave reviews and feedback*** on products they have purchased. These reviews not only assist other customers in making informed purchasing decisions but also provide valuable insights for PurchaseOnn to improve its products and services.

By prioritizing customer feedback and engagement, PurchaseOnn fosters stronger relationships with its customers, leading to increased loyalty and long-term growth.

REVENUE STREAMS

PurchaseOnn's ***revenue streams*** are diverse, reflecting the various ways it generates income. The primary source of revenue is the ***sale of products***, including both its own offerings and third-party items. Additionally, PurchaseOnn monetizes through ***advertising, featuring ads and sponsored products*** for other companies. The company also provides various services, such as ***selling e-books and music, renting movies and TV shows, and offering access to streaming services***. Another significant revenue stream comes from the ***frame membership***, which provides customers with benefits like free shipping and exclusive access to streaming services, available through annual, quarterly, or monthly subscriptions. Lastly, PurchaseOnn operates a cloud computing platform called PurchaseOnn Web Services (PWS), which offers businesses ***server capacity and other resources on a pay-per-use basis***.

These combined revenue streams ensure a steady and diverse income for PurchaseOnn, supporting its growth and market dominance.

KEY RESOURCES

Key resources describe the most important assets indispensable to a business. PurchaseOnn relies on a broad range of key resources crucial to its business model.

PurchaseOnn's ***online platform***, the central hub for selling products and providing services, also serves as the main source of customer reviews and feedback. Customer data is another vital resource, as PurchaseOnn collects and analyzes this data to offer personalized recommendations and advertising, thereby improving site offerings and usability. **Skilled software engineers/ staff** are essential for creating and maintaining the online platform infrastructure.

The company's ***delivery and logistics infrastructure***, which includes its own warehouses and logistics centers along with partnerships with freight forwarders and courier services, ensures quick and reliable product delivery. The ***PurchaseOnn brand*** itself is also a key resource, representing trust and reliability to customers and partners alike.

Together, these key resources are fundamental to PurchaseOnn's operations and success.

COST STRUCTURE

The costs involved in operating PurchaseOnn's business encompass a wide range of expenses necessary to maintain its ***platform and services***. Key expenses include the development and maintenance of websites and apps, cloud services, database management and information security. Significant ***marketing and advertising costs*** involve search engine advertising, social media advertising, and ad placements in both print and online media. Additionally, ***costs related to procurement, storage, packing, and shipping of goods, along with commissions paid to sellers and real estate expenses***, are crucial for the business.

Staff costs, including salaries, wages, employee training and development, and human resources management, along with ***general and administrative costs*** covering office equipment and supplies, travel and lodging, insurance, taxes, and other administrative activities, represent a portion of expenses.

Together, these costs ensure the smooth and efficient operation of PurchaseOnn's business activities, including maintaining its physical spaces such as fulfilment centres, sortation centres, and delivery stations.

7. In accordance with Ind AS 16, all costs required to bring an asset to its present location and condition for its intended use should be capitalised. Therefore, the initial purchase price of the building would be:

Particulars	Amount (₹)
Purchase amount	50,00,000
Non-refundable property tax	2,50,000

Direct legal cost	50,000
	53,00,000
Expenditures on redevelopment: Building plan approval	1,00,000
Construction costs (10,00,000 –60,000)	9,40,000
Total amount to be capitalised on 1st October 2023	63,40,000

Treatment of abnormal wastage and material and labour: As per Ind AS 16, the cost of abnormal amounts of wasted material, labour, or other resources incurred in self-constructing an asset is not included in the cost of the asset. It will be charged to Profit and Loss in the year it is incurred. Hence, abnormal wastage of ₹ 40,000 will be expensed off in Profit & Loss in the financial year 2023 -2024.

Accounting of property- Building

When the property is used as an administrative centre, it is not an investment property, rather it is an 'owner occupied property'. Hence, Ind AS 16 will be applicable.

When the property (land and/or buildings) is held to earn rentals or for capital appreciation (or both), it is an Investment property. Ind AS 40 prescribes the cost model for accounting of such investment property.

Since equal value can be attributed to each floor, Ground Floor of the building will be considered as Investment Property and accounted as per Ind AS 40 and First Floor would be considered as Property, Plant and Equipment and accounted as per Ind AS 16.

Cost of each floor = ₹ 63,40,000 / 2 = ₹ 31,70,000

As on 1st October 2023, the carrying value of building vis -à-vis its classification would be as follows:

In Standalone Financial Statements: The Ground Floor of the building will be classified as investment property for ₹ 31,70,000, as it is property held to earn rentals. While First Floor of the building will be classified as item of property, plant and equipment for ₹ 31,70,000.

In Consolidated Financial Statements: The consolidated financial statements present the parent and its subsidiary as a single entity. The consolidated entity uses the building for the supply of goods. Therefore, the leased-out property to a subsidiary does not qualify as investment property in the consolidated financial statements. Hence, the whole building will be classified as an item of Property, Plant and Equipment for ₹ 63,40,000.

CASE STUDY 17

Maxplus Ltd, (herein referred as to the 'company') one of the most trusted gateways to medicines, incorporated in Delhi with an aim to eliminate fake and ineffective medicines, and supply good quality medicines in India. According to WHO research, every 1 or 2 in 10 medicines are adulterated in low/medium income countries like India. Consequently, the company aspires to bring about a change in these statistics. To improve transparency in the functioning of the pharmaceutical industry, the company has been successfully contributing to providing genuine and unadulterated medicines since its incorporation. Also, as the market demands, a constant customer loyalty program is also introduced by the company, where in on eligible purchases, the customers can avail cash discounts or can enjoy incentive points which can be converted into required products like blood pressure testing apparatus, diabetes testing apparatus, medicated / scented floor cleaner etc. Entire operation of the company can be broadly classified into two divisions – (a) Retail outlet Division, and (b) Agency Division.

Retail outlet Division

Currently this chain of medical store, operates in 100 cities in India with 10 stores in each city. As per the accepted policy of the company, it does not involve in franchise model and all the outlets are operated by the company directly. Also, as per its policy, it does not operate its outlet from owned premises and all are in rented properties only which is under lease model. The stocks and sales are accounted and managed through a customised and specialized software developed by the company 2 years ago, which is inbuilt with various features like stock at a glance, outlet wise sales details, frequency of customer purchases etc., The IS officer of the company is a certified professional and the customer data base is protected in all respects.

With regard to its outlets, the company through its legal wing, enters into 3 years lease agreements with landlords for operating its stores in all the cities. As a part of vendor registration, the company captures all the details of landlords like PAN, TDS deductibility, MSME registration status, details GSTN (if any), type of the building (whether commercial or residential building), onus of payment of electricity payments, etc at the time of entering into lease agreements including the incorporation of escalation clause for rental value. According to the vendor database maintained by the company, out of the total 100 Landlords, only 50 Landlords are registered under GST law and raise GST invoices. 10 other landlords are registered under MSME Act. All the lease contracts stipulate the lessor will perform maintenance of the leased area and receive consideration for that maintenance service.

The company is capable of selecting similar places in different cities having similar lease rents. The company is also capable of finalizing all the lease contracts with similar terms and conditions. The contract includes the following fixed monthly prices payable at the end of every year for the lease and non–lease component: – (a) lease ₹ 27,000, (b) maintenance ₹ 3,000.

The company has the ability to forecast demand for its products with high accuracy and it has sufficient working capital requirements that can help it stock up inventory. Demand is continuous throughout the year. Hence, its inventory turnover is high. The profit margin earned from its sales are high and generate sufficient cash flow. The working capital needs of the company are sufficiently met by internal reserves. All these factors can enable the company to sell its products on a large scale in anticipation of demand. Inventory can be stocked up and sold when the demand for it arises.

Agency Division

The company is also the leading trader / dealer of an extensive array of Medical Equipments. Maxplus directs all its activities to cater to the expectations of customers by providing them excellent quality products as per their gratifications. On the basis of its strict quality principles, it has been able to serve its customers earnestly.

In the retail outlet division, the company regularly purchases different varieties of medicines through centralized procurement system, and they are distributed to the outlets which are sold to customers. Unsold medicines are held as stock in hand. However, it buys medical equipment only when the customer gives purchase order along with the product specifications. The delivery of such medical equipment is directly done by the corporate office. During the financial year, Maxplus has imported CT scan machine by air and provided this machine to a hospital governed by a charitable trust. The hospital is registered under section 12AB of the Income Tax Act and involved in healthcare services.

Particulars	US $
Price at exporter's factory	8,500
Freight from factory of the exporter to load airport (airport in the country of exporter)	250
Loading and handling charges at the load airport	250
Freight from load airport to the airport of importation in India	4,500
Insurance charges	2,000

Though the aircraft arrived on 22.08.2023, the bill of entry for home consumption was presented on 20.08.2023. The Chief Tax Officer (CTO) of the company is uncertain about the computation of Assessable value of the CT Scan Machine. He needs clarity about the following issues –

1. Which rate of basic customs duty and exchange rate should be applied – Whether the rate prevailing on arrival of aircraft or the rate prevailing on the date of presentation of bill of entry?

2. Which rate of exchange should be applied – Whether the exchange rate notified by CBIC or the exchange rate prescribed by RBI?

Rate of basic customs duty on 20.08.2023 was 20%. On 21.08.2023, the newly elected Government unexpectedly reduced the Rate of basic customs duty to 10%. He furnishes all the relevant details –

Particulars	20.08.2023	22.08.2023
Exchange rate notified by CBIC	₹ 80 per US$	₹ 83 per US$
Exchange rate prescribed by RBI	₹ 81 per US$	₹ 82 per US$
Integrated tax leviable u/s 3(7) of the Customs Tariff Act, 1975	18%	12%

For the import of the aforesaid machine, the company is liable to settle the exporter in 3 months. Hence, at the time of import of the machine, the company has entered into forward contracts to hedge the foreign currency cash flows without considering the other hedging alternatives like options contract & money market hedging opportunities prevailing at that time. The details of the rates of exchange and other derivative products at the time of acquisition is provided hereunder –

Spot rates ₹ 80.23 – ₹ 80.98

Interest rate in India 10% p.a.

Interest rate in US 4% p.a.

Actual forward rates commensurate with theoretical forward rates. At the time of entering into forward contract, the bank charges a margin of 0.5% on its buying and selling rate.

	Call Option	
Strike Price	₹ 81.21	0.01218
Premium	₹ 1.50	50 cents

Particulars of Well-Well Outlet

Well-Well Outlet is located in a town with many colleges and universities around it. The town has a substantial student population, most of whom are health-conscious and regular buyers of health products. Business for this particular outlet has been slow in recent years due to the advent of online pharmacies that offer convenience, discounts, and time-saving benefits. However, the management continues to believe that students would still prefer the personal service, immediate availability, and expert advice that only a physical pharmacy can offer. Accordingly, management have framed a plan to attract students by offering discounts on health products.

The average time a student spends at the college or university is 4 years, which is the average duration of any course. For a nominal one-time subscription fee, Well-Well plans to offer students discounts on health products for a period of 4 years. By attracting more footfalls, Well-Well targets to cross-sell its wellness products and health supplements. This would help it sustain a reasonable revenue each year.

Well-Well would attract attention to the plan by initially offering free health check-ups, wellness products, and gift vouchers. This one-time initial expense, net of the one-time subscription fee collected, would cost ₹ 5,000 per student. On subscription to the plan, the purchases of each student are expected to be as follows:

Particulars	Years 1 and 2	Years 3 and 4
Spend on health products per year	₹ 2,000	₹ 1,500
Spend on wellness products per year	₹ 4,000	₹ 3,000
Spend on health supplements per year	₹ 2,250	₹ 750

Assumptions:

1. Only 50% of the subscribers are expected to visit the pharmacy in years 3 and 4.
2. Across all years, only 75% of the subscribers who visit the outlet are expected to buy wellness products.
3. Only 25% of the subscribers who visit are expected to buy health supplements in years 1 and 2, and 10% of them in years 3 and 4.

Financial Reporting Considerations

As Maxplus Ltd. prepares its annual financial statements for the year ending 31st March, 2024, several critical issues have come to light that require careful consideration and disclosure.

Firstly, during the financial statement preparation process, it discovered that a provision for constructive obligation for payment of bonus to selected employees in the corporate office (material in amount) which was required to be recognized in the annual financial statements for the year ended 31st March, 2022 was not recognized due to oversight of facts. The bonus was paid during the financial year ended 31st March, 2023 and was recognized as an expense in the annual financial statements for the said year.

Secondly, in November 2023, Company entered into a loan agreement with a bank. The loan is repayable in 6 equal annual installments starting from November 2028. One of the loan covenants is that an amount equivalent to the loan amount should be contributed by the promoters of the Company by 4th March, 2024, failing which the loan becomes payable on demand.

As on 4th March, 2024, the Company has not been able to get the promoter's contribution. On 5th March, 2024, the Company approached the Bank and immediately obtained a grace period up to 30th June, 2024 to get the promoter's contribution. The bank cannot demand immediate repayment during the grace period.

These developments highlight the importance of accurate financial reporting and proactive management of loan covenants to maintain financial stability and compliance.

I. Multiple Choice Questions

1. As at 31st March, 2024, how should the Company classify the loan?
   (a) The loan will be considered as a current liability.
   (b) The loan will be considered as a non -current liability.
   (c) The loan will be considered as a deferred tax liability.
   (d) The loan will be considered as provisions.
2. Assume that it may not be able to get the promoter's contribution by the due date, the Company approached the Bank in January 2024 and got the compliance date extended up to 30th June, 2024 for getting promoter's contribution. Will the loan classification as at 31st March, 2024 be different from 1 above?
   (a) The loan will be considered as a current liability.
   (b) The loan will be considered as a non -current liability.
   (c) The loan will be considered as a deferred tax liability.
   (d) The loan will be considered as provisions.

3. Which of the following is true?

   i. Push model supply chain is suitable for the Retail Outlet Division.

   ii. Pull model supply chain is suitable for the Agency Division.

   iii. Risk of pull model supply chain is overstocking & locking of working capital in the inventory.

   iv. High inventory turnover ratio implies working capital gets locked in the inventory for a longer period of time.

   (a) i, ii, iv

   (b) i, ii, iii, iv

   (c) i, ii, iii

   (d) i, ii

4. Why does Maxplus Ltd. not use the franchise model for its retail outlets?

   (a) To avoid legal complications

   (b) To maintain direct control over operations

   (c) Due to lack of knowledge from potential franchisees

   (d) Because of the high cost of franchise fees

5. During the F.Y. 2023–2024, if the cost of all other common inputs (other than lease rent) is ₹ 200 crores and total sales is ₹ 300 Crores (60% attract 18% GST and balance are exempt supplies), the amount of eligible ITC attributed for effecting taxable supplies by the company will be –

   (a) 36 Crores

   (b) 36.108 Crores

   (c) 21.7944 Crores

   (d) 60 Crores

   Note: Ignore ITC on Integrated tax leviable under section 3(7).

II. Descriptive Questions

6. Compute the value of CT scan machine for the purpose of levying customs duty as well as the customs duty and tax payable.

7. The company has 3 choices: (i) Forward cover (ii) Money market cover, and (iii) Currency option. Which of the alternatives is preferable by the company? (Note: Compute INR required under different alternatives for buying 1 USD after 3 months and also the INR/USD exchange rate value should be upto 4 decimal points)

8. For the year 2023-2024 you are required to analyse whether the situation relating to constructive obligation for payment of bonus is an error requiring retrospective restatement of comparatives considering that the amount is material.

9. With reference to Well-Well Outlet, calculate the customer lifetime value per subscriber. Given that PVIFA of ₹ 1 for 4 years at 10% = 3.169 and PVIFA of ₹ 1 for 2 years at 10% = 1.735.

ANSWERS TO THE CASE STUDY 17

I. Answers to the Multiple Choice Questions

1. (a) The loan will be considered as a current liability

Reason: Paragraph 75 of Ind AS 1, inter alia, provides that an entity classifies the liability as non-current if the lender agreed by the end of the reporting period to provide a period of grace ending at least twelve months after the reporting period, within which the entity can rectify the breach and during which the lender cannot demand immediate repayment.

In the present case, following the default, grace period within which an entity can rectify the breach is less than twelve months after the reporting period. Hence as on 31st March, 2022, the loan will be classified as current.

2. (b) The loan will be considered as a non -current liability

Reason: Ind AS 1 deals with classification of liability as current or non-current in case of breach of a loan covenant and does not deal with the classification in case of expectation of breach. In this case, whether actual breach has taken place or not is to be assessed on 30th June, 2024, i.e., after the reporting date. Consequently, in the absence of actual breach of the loan covenant as on 31st March, 2024, the loan will retain its classification as non-current.

3. (d) i, ii

Reasons: Under Push Model stocks are produced on the basis of anticipated demand. Demand forecasting can be done via a variety of sophisticated techniques, such as operations research or data mining.

Under Pull Model stocks are produced in response to actual demand. This new business model is less product-centric and more directly focused on the individual consumer: a more marketing- oriented approach.

This statement that the Risk of pull model supply chain is overstocking & locking of working capital in the inventory is incorrect as in pull model , stocks are produced in response to actual demand , thus the question of overstocking doesn't arise.

High inventory turnover ratio implies working capital doesn't gets locked in the inventory for a longer period of time as inventory is quickly converted into sales.

Thus, only i and ii statements are correct.

4. (b) To maintain direct control over operations

Reason: Maxplus Ltd. does not use the franchise model for its retail outlets primarily **to maintain direct control over operations**.

By directly operating all its retail outlets, the company ensures that its high standards for quality and service are consistently met across all locations.

5. (c) 21.7944 Crores

Reason: If common inputs, input services and capital goods are used for taxable as well as exempt supply, only proportionate ITC attributable to the taxable supply is available. The common ITC is apportioned in the ratio of value of taxable supply and exempt supply.

ITC on all other common inputs (other than Rent) = ₹ 200 Crores × 18% = ₹ 36 Crores

ITC on Rent = ₹ 30,000 pm × 12 months × 50 Landlords × 18% = ₹ 32.40 Lakhs

Total ITC on all other common inputs & Rent = ₹ 36.324 Crores

Total ITC eligible on all other common inputs & Rent= ₹ 36.324 Crores×60% = ₹ 21.7944Crores

II. Answers to the Descriptive Questions

6. Computation of assessable value of the machine

Particulars		Amount
Ex-factory price of the goods		8,500 US $
Freight from factory of the exporter to load airport (airport in the country of exporter)	250 US $	

Loading and handling charges at the load airport	250 US $	
Freight from load airport to the airport of importation in India	4,500 US $	
Total cost of transport, loading and handling charges associated with the delivery of the imported goods to the place of importation	5,000 US $	
Add: Cost of transport, loading, unloading and handling charges associated with the delivery of the imported goods to the place of importation (restricted to 20% of FOB value) [Note 1]		1,800 US $
Insurance (actual)		2,000 US $
CIF for customs purpose		12,300 US $
Value for customs purpose		12,300 US $
Exchange rate as per CBIC [Note 2]		₹ 80 per US $
		Amount (₹)
Assessable value (₹ 80 x 12,300 US $)		**9,84,000**
Add: Basic customs duty @ 10% [Note 3]		98,400
Add: SWS @ 10%		9,840
Value for the purpose of levying integrated tax [Note 4]		10,92,240
Add: Integrated tax @ 12%		1,31,068.8
Total duty & tax payable (rounded off)		**2,39,309**

Notes:

(1) In the case of goods imported by air, the cost of transport, loading, unloading and handling charges associated with the delivery of the imported goods to the place of importation shall not exceed 20% of the FOB value of the goods. [Fifth proviso to rule 10(2) of the Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 (CVR)].

FOB value in this case is the ex-factory price of the goods (8,500 US $) plus the cost of transport from factory to load airport (250 US $) plus loading and handling charges at the load airport (250 US $) which is 9,000 US $.

(2) Rate of exchange determined by CBIC is to be considered [Clause (a) of the explanation to section 14 of the Customs Act, 1962].

(3) Section 15 of the Customs Act, 1962 provides that rate of duty shall be the rate in force on the date of presentation of bill of entry or the rate in force on the date of arrival of aircraft, whichever is later.

(4) Integrated tax is levied on the sum total of the assessable value of the imported goods and customs duties [Section 3(8) of the Customs Tariff Act, 1962]. SWS leviable on integrated tax have been exempted.

7. Alternative 1: Forward Contract

The company is required to buy USD for INR after 3 months. Hence, the relevant rate applicable for the company will be 3 months ForwardAsk INR / USD. According to the interest rate parity theory, the relationship between forward rate and spot rate can be explained as under –

$$\text{3 months forwardask INR / USD} = \text{Spot ask INR / USD} \times \frac{1+\text{3months Interest Rate in India}}{1+\text{3 months Interest Rate in US}}$$

$$\text{3 months forwardask INR / USD} = ₹\ 80.98 \times \frac{1.025}{1.01} = ₹\ 82.1826$$

Since the bank charges 0.5% Margin, total INR required for buying 1 USD will be ₹ 82.5935 (₹ 82.1826 + 0.5%)

Alternative 2: Call Option Contract

Exercise Price	₹ 81.21
Option Premium payable at the time of buying Option	₹ 1.50
Interest for option premium for 3 months (₹ 1.50 × 10% × 3/12)	₹ 0.0375
INR required for buying 1 USD	**₹ 82.7475**

Or without interest **₹ 82.7100**

Alternative 3: Money Market Hedge

Action: USD payable in 3 months.

1. Invest now the Present value of 1 USD = 1/1.01 = USD 0.9901
2. Buy USD 0.9901 for INR = ₹ 80.98 (1+ 0.5%) × USD 0.9901 = ₹ 80.5792
3. Borrow ₹ 80.5792 at 10% for 3 months
4. Repay along with Interest = ₹ 82.5937

Summary of Alternatives for buying 1 USD after 3 months

	Forward	Options	Money Market Hedge
INR payable per USD	₹ 82.5909	₹ 82.7475	₹ 82.5937

Since the Cash outflow is lower in case of **Forward Market Hedge**, it is preferable.

8. As per paragraph 41 of Ind AS 8, errors can arise in respect of the recognition, measurement, presentation or disclosure of elements of financial statements. Financial statements do not comply with Ind AS if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity's financial position, financial performance or cash flows. Potential current period errors discovered in that period are corrected before the financial statements are approved for issue. However, material errors are sometimes not discovered until a subsequent period, and these prior period errors are corrected in the comparative information presented in the financial statements for that subsequent period.

As per paragraph 40A of Ind AS 1, an entity shall present a third balance sheet as at the beginning of the preceding period in addition to the minimum comparative financial statements if, inter alia, it makes a retrospective restatement of items in its financial statements and the retrospective restatement has a material effect on the information in the balance sheet at the beginning of the preceding period.

In the given case, expenses for the year ended 31st March, 2022 and liabilities as at 31st March, 2022 were understated because of non-recognition of bonus expense and related provision. Expenses for the year ended 31st March, 2023, on the other hand, were overstated to the same extent because of recognition of the aforesaid bonus as expense for the year. To correct the above errors in the annual financial statements for the year ended 31st March, 2024, the entity should:

(a) restate the comparative amounts (i.e., those for the year ended 31st March, 2023) in the statement of profit and loss; and

(b) present a third balance sheet as at the beginning of the preceding period (i.e., as at 1st April, 2022) wherein it should recognise the provision for bonus and restate the retained earnings.

9. Customer lifetime value per subscriber can be found by calculating the present value of the revenue that is generated over the period of 4 years. This netted out with the cost incurred to attract subscribers, would give the customer lifetime value per subscriber.

Sr. No.	Particulars	Revenue (per year)	PVIFA	PV of Revenue	Probability of Usage	Net Revenue
1	Net cost of attracting students (onetime expense)					5,000
2	Net revenue from health products					
	Years 1-2	2,000	1.735	3,470	100%	3,470
	Years 3-4 (refer note 1)	1,500	1.434	2,151	50%	1,076
3	Sale of wellness products					
	Years 1-2	4,000	1.735	6,940	75%	5,205
	Years 3-4 (refer note 2)	3,000	1.434	4,302	37.5%	1,613
4	Sale of health supplements					
	Years 1-2	2,250	1.735	3,904	25%	976
	Years (refer note 3)	750	1.434	1,076	5%	54
5	Total revenue (Steps 2+3+4)					12,394
6	Net revenue from subscription plan (steps 5-1)					7,394

Notes :

1. PVIFA (10%, 4 years) = 3.169 and PVIFA (10%, 2 years) is 1.735. Therefore, PVIF for years 3 and 4 = PVIFA (10%, 4 years) - PVIFA (10%, 2 years) = 3.169 - 1.735 = 1.434.

2. Only 50% of the subscribers are expected to visit in years 3 and 4. Out of those only 75% are expected to buy wellness products. Therefore, only 37.5% of the subscribers (75% of 50% subscribers who visit) are expected to buy wellness products in years 3 and 4.

3. Only 50% of the subscribers are expected to attend in years 3 and 4. Out of those only 10% are expected to buy health supplements. Therefore, only 5% of the subscribers (10% of 50% subscribers who visit) are expected to buy health supplements in years 3 and 4.

   Present value of total revenue generated over the four-year period by a customer is ₹12,393 while the corresponding expense is ₹5,000. Therefore, the customer lifetime value per subscriber is ₹7,394. Well-Well has to multiply this with the expected number of subscribers each year, to find out if this would be a profitable proposition.

CASE STUDY 18

India's Smartphone market shipped 8 million smartphones in 2023 with a normal one percent growth year-on-year basis. Market size was valued at USD 169.72 billion in 2023 and is expected to reach USD 341.40 billion by 2030 as per International Data Corporation Report dated February 13,2024.

Soft Tech Limited (STL), an Indian company, started its operations three years ago to manufacture Smart Phones and provision of IT-software services. The objective of the company was to catch the market-share of the growing smartphone industry.

The STL company has entered into contract with its sole-distributor MJ & Co. in North India to supply Smartphone and Software license. The software may be substantially customised to add significant new functionality to enable the software to integrate with smartphone applications used by the customers. The company also sells the smartphones and the software license separately to other distributors in the country. Customers can also buy smartphones and software license separately from other vendors in the country.

STL has entered into a one-year contract on 1st April of current financial year (FY) with Distributor MJ to deliver Smartphones with customised software by offering discounted prices for certain volumes as given hereunder:

Price per Smartphone	Cumulative sales volume (units)
₹ 10,000	1 – 2500
₹ 9,500	2501 – 5000
₹ 9,000	5001 and above

Volume is determined based on sales during the FY. There are no minimum purchase requirements. STL has estimated that total sales volume to distributor MJ for the current FY would be 4000 units based on its experience with similar contracts.

STL company has estimated that 8,500 units of Smartphones (including 4000 units to MJ Distributor) would be sold in current FY with market share of 1%, and the average contribution of ₹ 2000 per unit will be achieved. However, at end of current FY, the STL company actually sold 10,000 units of Smartphones (including 4500 units to MJ Distributor) by achieving market share of 1.25 %.

Recently, smartphone users have been experiencing issues with app crashes, which has become a significant concern for the company. In response, the company is planning to enhance not only the operating system but also the touch screen of its devices. By improving these aspects, the company aims to provide a more responsive and reliable user experience, potentially reducing the frequency of app crashes.

The CFO of the STL company wishes to increase its market share to 2% in next five years. For this purpose, he wants to double the production of smartphones for which additional funds are required. Bank is ready to finance for expansion of smartphone operations of the company but maximum up to 60% of valuation of smartphone business. The CFO has been provided the following information of the company by the Accounts Manager:

Particulars	₹ in lakhs
Property, Plant and Equipment (PPE) employed	300
Working capital	200
Equity	200
9% Debt	300
Corporate tax rate	30 %
Risk-free rate of return	6 %
Asset beta of Industry	0.6
Market rate of return in the industry	10 %
NOPAT for current year	200
Sales revenue for current year	1000

The PPE is being depreciated at the rate of 20% p.a. on opening balances; the sale revenue and Net Operating Profit After Tax (NOPAT) would grow at the rate of 20% p.a. for next 3 years. Sales revenue will be stable from 4th year onwards and incremental capital expenditure will be offset by depreciation. Assets (PPE) and working capital turnover ratio shall remain constant all over the years.

JB Ltd, Canada, holds 25% equity in STL company. Further JB Ltd has appointed 30% directors of STL company; has advanced loan amounting to 25% of book value of total assets of STL Company of ₹ 500 lakhs and has guaranteed 25% of total borrowings (total debt ₹ 300 lakhs) of STL company. During current financial year, STL company has sold 1000 units of Smartphones @ ₹ 7000 to JB Ltd. The total costs (direct and indirect) for these 1000 units transferred amounted to ₹ 60,00,000. However, STL company billed CD Ltd, India (unrelated to STL company) at the rate of ₹ 9500 per unit of smartphone and earned a gross profit of 50% on its costs. The transactions of STL company with JB Ltd and CD Ltd are comparable, subject to the following differences:

a)	STL company derives technology support from JB Ltd but there is no such support from CD Ltd. The value of technology support is estimated at 12% of normal gross profit.
b)	JB Ltd gives business in large volumes. STL company offered to JB Ltd a quantity discount valued at 8% of normal gross profits.

c)	For supply of smartphones to JB Ltd, STL company neither runs any risk nor incurs any marketing costs but in case of supply to CD Ltd, STL company has to assume all the risk and costs associated with the marketing function are estimated at 10% of the normal gross profits.
d)	STL company offered three-months credit to JB Ltd. The cost of providing such credit may be valued at 2% p.m. of the gross profits. No such credit was given to CD Ltd.

I. Multiple Choice Questions

1. Determine which of the following statements correctly explain the customer's pains:

   (a) App crash

   (b) Touch screen technology

   (c) The operating system

   (d) Slow screen-touch response

2. Using the Kano Model of product development and customer satisfaction, which feature does the touch screen/operating system fall under?

   (a) Performance attribute

   (b) Indifferent qualities

   (c) Threshold attribute

   (d) Reverse qualities

3. STL company provides the customer with Software License that will be significantly customised and installed to make the software function with the Smartphones bought by the customer from the company. STL company also sells Smartphone and Software License separately in the open market. Determine whether the company has a single or multiple performance obligations under the contract with customer in accordance with Ind AS 115, 'Revenue from Contract with Customers'.

   (a) The company has two separate performance obligations, one is for supply of Smartphone and second is supply of Software License because they can be sold separately in the open market

   (b) The company has two separate performance obligations, one is for supply of Smartphone and second is supply of Software License because they are not inter-related

   (c) The company has single performance obligation for smartphone and software license because license is significantly customised to function with the smartphone

(d) The company has single performance obligation for smartphone and software license because they are sold to same customer at same time

4. Determine the amount of Market Size Variance & Market Share for smartphones during current FY

(a) Market Size Variance - ₹ 10 lakhs (A); Market Share Variance - ₹ 40 lakhs (F)

(b) Market Size Variance - ₹ 10 lakhs (F); Market Share Variance - ₹ 40 lakhs (A)

(c) Market Size Variance - ₹ 40 lakhs (A); Market Share Variance - ₹ 10 lakhs (F)

(d) Market Size Variance - ₹ 40 lakhs (F); Market Share Variance - ₹ 10 lakhs (A)

5. Are STL Company and JB Ltd., Canada associated enterprises? If so, why?

(a) Yes, STL Company and JB Ltd, Canada are associated enterprises because JB Ltd., Canada holds substantial equity interest of 25% in STL Company which is > 20% of equity of STL Company

(b) Yes, STL Company and JB Ltd, Canada are associated enterprises since JB Ltd, Canada has guaranteed 25% of total borrowings of STL which is > 10% of total debt of STL Company

(c) Yes, STL Company and JB Ltd, Canada are associated enterprises since JB Ltd, Canada has advanced loan amounting to 25% of book value of total assets of STL Company which is > 10% of book value of total assets of STL

(d) No, STL Company and JB Ltd, Canada are not associated enterprises

II. Descriptive Questions

6. Soft Tech Ltd (STL) has actually sold 2000 units of Smartphones to Distributor MJ for the half year ending on 30th September and has sold 4500 units of smartphones for the current FY ending on 31st March. Determine the transaction price and the amount of revenue to be recognised by Soft Tech Ltd for the half-year ending on 30th September for the current year as a whole ending and on 31st March in accordance with Ind AS 115. Necessary journal entries should be recorded in the books of STL for the current FY.

7. Determine the amount of bank finance available for expansion of operations of smartphones in accordance with proposal given by CFO of the company.

8. Compute the Arm's Length Price as per section 92 of Income tax act, 1961, along with income to be increased for current financial year of Soft Tech Ltd under the Cost Plus Method for the transactions entered into by the Soft Tech company with JB Ltd, Canada.

ANSWERS TO THE CASE STUDY 18

I. Answers to the Multiple Choice Questions

1. (a) App crash

Reason: Customers are experiencing issues with app crashes, causing significant inconvenience and leading to dissatisfaction among users.

2. (c) Threshold attribute

Reason: When these characteristics are met, they are taken for granted, but when they are not met, they cause dissatisfaction. Customers expect these qualities and regard them as basic; it is unlikely that they will mention them to the company when asked about quality attributes.

3. (c) The company has single performance obligation for smartphone and software license because license is significantly customised and integrated to function with the smartphone.

Reason: The customer cannot use the smartphone without integration of software license

4. (a) Market Size Variance - ₹ 10 lakhs (A); Market Share Variance - ₹ 40 lakhs (F)

Reason: Market Size Variance = [Actual Industry Sales Volume – Budgeted Industry Sales Volume] x Budgeted Market Share % x Budgeted Average Contribution (Margin) p.u.

Actual Industry Sales Volume = 10000/1.25% = 8,00,000 units

Budgeted Industry sales volume = 8500/1% = 8,50,000

Market Size variance = (8,00,000 – 8,50,000) x 1% x ₹ 2000 = ₹ 10 lakhs Adverse

Market Share Variance = [Actual Market Share % – Budgeted Market Share %] x Actual Industry Sales Volume x Budgeted Average Contribution (Margin) p.u.

Market share variance = (1.25 % – 1%) x 8,00,000 x ₹ 2000 = ₹ 40 lakhs Favourable

5. (b) Yes, STL Company and JB Ltd, Canada are associated enterprises since JB Ltd, Canada has guaranteed 25% of total borrowings of STL which is > 10% of total debt of STL Company

Reason: As per section 92A one entity becomes associated enterprise of another entity in any of the following cases:

(i) If one entity holds ≥ 26% voting power of other entity

(ii) If one entity has advanced loan of 51% or more of book value of total assets of other entity

(iii) If one entity has appointed more than half of the board of Directors of other entity

(iv) If one entity has guaranteed 10% or more of total borrowings of other entity.

In the given case, condition (iv) is satisfied.

II. Answers to the Descriptive Questions

6. **(a)** Transaction price The transaction price is ₹ 9500 per smartphone based on best estimate of total sales volume of 4000 units for the current FY to Distributor MJ

(b) Recognition of Revenue would be recognised at a selling price of ₹ 9500 per smartphone sold.

For the half year ended on 30th September, STL company shall recognise revenue of ₹ 190 lakhs (2000 units sold x ₹ 9500), though they will charge ₹ 10,000 per unit.

For the whole current FY, STL company shall recognise revenue on actual sales basis for ₹ 427.50 lakhs (4500 units x ₹ 9500).

(c) Recognition of Liability For the half year ended on 30th September: STL company shall also recognise a liability (advance from customer) for excess price realised amounting to ₹ 10 lakhs (2000 units x ₹ 500).

The accounting entries in books of STL company for current FY

Date (Current FY)	Particulars	Dr (₹)	Cr (₹)
30th Sept.	Bank or Receivables A/c Dr.	200,00,000	
	To Sales Revenue A/c		190,00,000
	To Advance from customers (liability) A/c		10,00,000
31st March	Bank or Receivables A/c Dr. Advance from customers (liability) A/c Dr. To Sales Revenue A/c	327,50,000* 10,00,000	 427,50,000

* Balancing Figure

7. Computation of Bank Finance available for expansion of Operations of Smartphone as per Proposal of CFO

Calculation of Depreciation on assets (PPE) and Working Capital (₹ in lakhs)

Projected Years	0	1	2	3	4 and onwards
Opening balance of PPE		300	360	432	518.40
Less: Depreciation @ 20% for current year		(60)	(72)	(86.40)	(103.68)

Balance		240	288		414.72
Add: Purchases during current year		120	144	172.80	103.68
Closing balance of PPE at end of year		360	432	518.40	518.40
Sales	1000	1200	1440	1728	1728
Working capital (20% of Sales)	200	240	288	345.60	345.60

Calculation of Free Cash Flows from expansion of Operations of Smartphones (₹ in lakhs)

Particulars	Year 1	Year 2	Year 3	Terminal year
NOPAT	240	288	345.60	345.60
Add: Depreciation	60	72	86.40	-
Less: Increase in PPE	(120)	(144)	(172.80)	-
Less: Increase in working capital	(40)	(48)	(57.60)	-
Free cash flows for firm (FCFF)	**140**	**168**	**201.60**	**345.60**

Calculation of Weighted Average Cost of Capital (WACC) for Smartphone Operations of Soft Tech Ltd

Equity Beta (βe)	=	Asset beta (1 + Debt-equity ratio after tax) βa x [1 + D/E (1 – t)] = 0.6 [1 + 1.5 (0.7)] = 1.23
Cost of Equity (Ke)	=	Rf + βe (Rm – Rf) = 6% + 1.23 (10% - 6%) = 10.92 %
Cost of debt after tax (Kd)	=	9 % x (1 – 30%) = 6.3 %
WACC (Ko)	=	Kd. Wd + Ke. We = 6.3 (0.6) + 10.92 (0.4) = 8.148 %

Calculation of Total Valuation of Operations of Smartphone of Soft Tech Ltd

Years	FCF (₹ in lakhs)	PVF @ 8.148 %	PV of FCF (₹ in lakhs)
1	140	0.925	129.50
2	168	0.855	143.64
3	201.6	0.791	159.466
Terminal	345.60/ 8.148 % = 4241.53	0.791	3355.05
Total			**3787.656 or 3788**

Maximum bank finance available for expansion of operations of smartphone = 60% of ₹ 3788 lakhs = ₹ 2273 lakhs or 60% of ₹ 3787.656 lakhs = ₹ 2272.594 lakhs.

8. Soft Tech Ltd (STL), an Indian company and JB Ltd, a Canadian company, are deemed to be Associated Enterprises u/s 92A of Income tax Act, 1961. The transaction of supply of smartphones by STL to JB Ltd, Canada, is an international transaction u/s 92B and, therefore, transfer pricing provisions would be attracted in this case. The arm's length price under cost plus method shall be computed as follows:

Particulars	GP ratio
Gross profit mark-up on cost in case of CD Ltd (an unrelated party)	50 %
***Less*: Adjustments for functional and other differences**	
Value of technology support [JB Ltd. provides technology support, but CD Ltd. does not provide such support. Therefore, value of technology support shall be adjusted] [12% of 50%, being gross profit]	(6%)
Quantity discount to JB Ltd. [Quantity discount is allowed to JB Ltd. as it gives business in large volumes, but the same is not provided to CD Ltd. Therefore, it shall be adjusted] [8% of 50%, being gross profit]	(4%)
Risk and cost associated with marketing [STL Ltd. has to bear all the risk and costs associated with the marketing function in case of CD Ltd., while there is no such risk in case of services to JB Ltd. Therefore, market risk and cost shall be adjusted] [10% of 50%, being gross profit]	(5%)
	35%
Add: Cost of credit to JB Ltd. [STL Ltd has provided credit of 3 months to JB Ltd. but not to the unrelated party. Therefore, adjustment for the cost of such credit has to be carried out to arrive at the ALP] (2% of 50% x 3 months)	3%
Arm's length gross profit mark up to cost	38 %
Cost incurred by STL for supply to JB Ltd	60,00,000
Add: Adjusted gross profit (₹ 60,00,000 x 38%)	22,80,000
Arm's length billed value	82,80,000
Less: Actual billed income from JB Ltd (₹ 7000 x 1000 units)	70,00,000
Increase in income of STL	**12,80,000**

CASE STUDY 19

As from last many years, it has been observed that people are returning back to their own country. India, as evidenced by economists all over the world, is not only the world's largest democracy but a country with untapped and unlimited economic potential. As there is a rising trend of companies in sectors such as pharmaceutical, manufacturing, automobiles, healthcare shifting more and more research and development work to India. This trend is leading many Indians to return from overseas to lead prime projects.

This situation is called as "reverse brain drains". It is form of brain drain where human capital moves in reverse from a more developed country to a less developed country that is developing rapidly. People returning back to their home country may accumulate savings, earn skills as well as knowledge which can be used in their home country. This became possible in India only due to strategies and long-term planning implemented by the Government to reverse the migration.

NRIs knowledge as well as experience can be applied in Indian context in numerous ways across all sectors whether it be managing MNC's, new business start -ups, domestic industries etc. For attracting NRIs, developing countries like India always endeavour to create an environment which will provide ample rewarding opportunities for those who have earned knowledge and skills from overseas.

Similarly, Mr. Pardeep, had left India in 2007. He was living in U.K. since then and finally moved back to India on 12th June 2023, where he had spent substantial part of his life. Mr. Pardeep was a non- resident in 9 years preceding the previous year 2023-24 but he visited India on various occasions and stayed in India for a total period amounting to 630 days during last 10 years preceding the previous year 2023-24. Mr. Pardeep wants to spend rest of his life in his home country.

He returned with one of his close friend Mr. John. Mr. John, a foreign national & a cricketer came to India as a member of England cricket team in the year ended 31st March, 2024 for 50 days. Mr. John received ₹ 5 Lakhs for participation in matches in India. He also received ₹ 1 Lakh for an advertisement of a product on TV. He contributed articles in a newspaper for which he received ₹ 10,000. When he stayed in India, he also won a prize of ₹ 10,000 from horse racing in Mumbai. He has no other income in India during the year.

After reaching India, Pardeep visited one of his close friend Anuj who is Chartered Accountant by profession, and he discussed all his details of income for the Financial Year 2023-24:

(i) Rental Income from the flat situated in London which was deposited in a bank there. The flat was given on rent by him after his return to India since July, 2023.

(ii) Dividends on the shares of three German companies which are being collected in a bank account in London. He proposes to keep the dividend on shares in London with the permission of Reserve Bank of India.

(iii) He has got two sons, one of whom is of 12 years and other son is major. Both his sons are staying in London and not returning to India with him. Each of his sons is having income of ₹ 75,000 in U.K. (not received in India) and of ₹ 20,000 in India.

(iv) During the preceding accounting year when he was a non-resident, he had sold 1,000 shares which were acquired by him in British Pound Sterling and the sale proceeds were repatriated. The profit in term of British Pound Sterling on sale of these 1,000 shares was 175% of the cost at ₹ 37,500 while in term of Indian Rupees it was ₹ 50,000

Mr. Pardeep came back to his parental house in Punjab where his parents were staying with Pardeep's younger brother, Mr. Gulshan. With the grace of God and blessings of parents, Mr Gulshan is also well settled in India. Presently, Mr Gulshan is managing a company i.e. Technologies Ltd being a director of company. Presently Technologies Ltd. has 9 directors. Company's Board of Directors desire to increase the number of directors from 9 to 16. But the Company Secretary of the company informed the company's Board of Directors that as per provisions of the Companies Act, 2013, every public company shall have **x** number of minimum and **y** number of maximum directors. But if the company wants to appoint more than the specified limit i.e. **y**, it can do so only after passing special resolution.

Technologies Ltd. has 2 divisions Laptops and Mobiles. Division Laptops has been making constant profits while division Mobiles has been invariably suffering losses. The company called a meeting for the discussion of financials of the company.

On 31st March, 2024, the division-wise draft extract of the Balance Sheet was:

(₹ in crores)

		Laptops	Mobiles	Total
Property, Plant and Equipment cost		500	1,000	1,500
Depreciation		(450)	(800)	(1,250)
Net Property, Plant and Equipment	(A)	50	200	250
Current assets:		400	1,000	1,400
Less: Current liabilities		(50)	(800)	(850)
	(B)	350	200	550
Total	(A+B)	400	400	800
Financed by:				
Loan funds		-	600	600
Capital: Equity ₹ 10 each		50	-	50

Surplus	350	(200)	150
	400	400	800

The management is of the opinion to sell Division Mobiles along with its assets and liabilities for ₹ 50 crores to Mobize Ltd. a new company, who will allot 2 crore equity shares of ₹ 10 each at a premium of ₹ 15 per share to the members of Technologies Ltd. in full settlement of the consideration, in proportion to their shareholding in the company. One of the members of the Technologies Ltd. was holding 52% shareholding of the Company.

I. Multiple Choice Questions

1. Tax liability of Mr. John for Assessment year 2024-25 would be:

   (a) ₹ 1,25,000

   (b) ₹ 1,30,000

   (c) ₹ 1,22,000

   (d) ₹ 1,70,000

2. Income earned by Mr. John in India would be subject to TDS. Income constituting ₹ 5,00,000 for participation in matches in India, ₹ 1,00,000 for an advertisement of a product on TV & ₹ 10,000 from articles contributed in newspaper would be subject to TDS at the rate _____ (excluding health & education cess) & ₹ 10,000 from horse racing in Mumbai would be subject to TDS at the rate _____ (excluding health & education cess)

   (a) 20%, 0%

   (b) 20%, 20%

   (c) 30%, 30%

   (d) 30%, 20%

3. What would be the residential status of Mr. Pardeep for the P.Y. 2023-24:

   (a) Non-Resident

   (b) Resident but ordinarily Resident

   (c) Resident but not ordinarily Resident

   (d) Resident because he is from Indian origin

4. Business combinations involving entities or businesses under common control shall be accounted for using the pooling of interest method. The pooling of interest method is considered to involve the following:

   (i) The assets and liabilities of the combining entities are adjusted to bring them to fair values.

   (ii) The assets and liabilities of the combining entities are reflected at their carrying amounts.

   (iii) The financial information in the financial statements in respect of prior periods should be restated as if the business combination had occurred from the beginning of the earliest period presented in the financial statements, irrespective of the actual date of the combination. However, if business combination had occurred after that date, the prior period information shall be restated only from that date.

   (iv) The identity of the reserves shall be preserved and shall appear in the financial statements of the transferee in the same form in which they appeared in the financial statements of the transferor.

   (v) The reserves of transferor shall not be preserved and shall not appear in the financial statements of the transferee.

   (vi) The difference, if any, between the amount recorded as share capital issued plus any additional consideration in the form of cash or other assets and the amount of share capital of the transferor shall be transferred to capital reserve.

   (vii) The difference, if any, between the amount recorded as share capital issued plus any additional consideration in the form of cash or other assets and the amount of share capital of the transferor shall be transferred to Goodwill/General Reserve.

   In the above context, which of the following is correct combination:

   (a) (i), (iii), (iv), (vi)

   (b) (ii), (iii), (iv), (vi)

   (c) (ii), (iii), (iv), (vii)

   (d) (i), (iii), (iv), (vii)

5. **x** & **y** equals to-

   (a) 2, 12

(b) 2, 15

(c) 3, 15

(d) 3, 12

II. Descriptive Questions

6. Mr. Pardeep provides the sources of his various income and seeks your opinion to know about his liability to income tax thereon in India in assessment year 2024-25 assuming that he has exercised the option to shift out of the default tax regime under section 115BAC.

7. Assuming that there are no other transactions, you are required to:

   (a) Pass journal entries in the books of Technologies Ltd.

   (b) Prepare the Balance Sheet of Technologies Ltd. after the entries in (a)

   (c) Prepare the Balance Sheet of Mobize Ltd.

ANSWERS TO THE CASE STUDY 19

I. Answers to the Multiple Choice Questions

1. (b) ₹ 1,30,000

Reason: Computation of tax liability of Mr. John for the A.Y. 2024-25

Particulars	(₹)	(₹)
Income taxable under the section 115BBA		
Income from the participation in matches in India	5,00,000	
Advertisement of product on TV	1,00,000	
Contribution of articles in newspaper	10,000	6,10,000
Income from Horse racing		10,000
Total Income		6,20,000
Tax @ 20% under section 115BBA on ₹ 6,10,000		1,22,000
Tax @ 30% under section 115BB on income of ₹ 10,000 from Horse races		3,000
		1,25,000
Add: Health & Education cess @ 4%		5,000
Total Tax Liability for Mr John for the A.Y. 2024-25		**1,30,000**

2. **(a)** 20%,0%

Reason: Income referred to in section 115BBA (i.e., ₹ 6,10,000, in this case) is subject to tax deduction at source @ 20% under section 194E.

Income referred to in section 115BB (i.e., ₹ 10,000, in this case) will not be subject to tax deduction at source since the amount did not exceed ₹ 10000 as per section 194BB.

3. **(c)** Resident but not ordinarily Resident.

Reason: Mr Pardeep returned to India on 12th June 2023 for permanently residing in India after staying in UK for 16 years. During the P.Y, 2023-24, he stayed in India for 294 days. Since he has stayed in India for a period of 182 days or more during the previous year 2023-24**, he would be a resident in India for the A. Y. 2024-25**. However, he would be a resident but not ordinarily resident because he was a non-resident in nine out of ten previous years preceding the P.Y 2023-24 or his stay in India during the 7 previous years is less than 730 days. The residential status of Pardeep for A.Y. 2024-25 is, therefore, **resident but not ordinarily resident.**

4. **(b)** (ii), (iii), (iv), (vi)

Reason: Business combinations involving entities or businesses under common control shall be accounted for using the pooling of interest method. The pooling of interest method is considered to involve the following:

(a) The assets and liabilities of the combining entities are reflected at their carrying amounts.

(b) The financial information in the financial statements in respect of prior periods should be restated as if the business combination had occurred from the beginning of the earliest period presented in the financial statements, irrespective of the actual date of the combination. However, if business combination had occurred after that date, the prior period information shall be restated only from that date.

(c) The identity of the reserves shall be preserved and shall appear in the financial statements of the transferee in the same form in which they appeared in the financial statements of the transferor.

(d) The difference, if any, between the amount recorded as share capital issued plus any additional consideration in the form of cash or other

assets and the amount of share capital of the transferor shall be transferred to capital reserve.

5. (c) 3, 15

Reason: As per Section 149(1) of Companies Act, 2013, every public company shall have-

Minimum Directors -3 and Maximum directors -15

However, the company can appoint more than 15 directors by passing special resolution in general meeting.

II. Answers to the Descriptive Questions

6. **As per section 5(1) of the Income-tax Act, 1961,** income which is received/ deemed to be received/ accrued or arisen/ deemed to accrue or arise in India is taxable in case of resident but not ordinarily resident. Income which accrues or arises outside India shall not be included in his total income unless it is derived from a business controlled in or a profession set up in India.

(i) Rental income from a flat in London which was deposited in a bank there shall not be taxable in the case of a resident but not ordinarily resident, since both the accrual and receipt of income are outside India.

(ii) Dividends from shares of three German companies, collected in a bank account in London, would also not be taxable in the case of a resident but not ordinarily resident since both the accrual and receipt of income are outside India.

(iii) As per section 64(1A), all income accruing or arising to a minor child is includible in the hands of the parent, after providing for deduction of ₹ 1,500 per child under section 10(32).

Accordingly, income of ₹ 20,000 accruing to his minor son, aged 12 years, in India is includible in the income of Pardeep, after providing a deduction of ₹ 1,500. Therefore, ₹ 18,500 is includible in the income of Pardeep. Income accruing to the minor child outside India (which is also received outside India) is not includible in the income of Mr Pardeep.

As given, his other son is a major son and hence, his income is not includible in the income of Pardeep.

(iv) Repatriation of sale proceeds of 1,000 shares sold in the preceding accounting year, when Pardeep was a non- resident, is not taxable in the A.Y. 2024-25 since it is not the income of the P.Y. 2023-24.

Consequently, only the income includible under section 64(1A) would form part of the total income of Mr. Pardeep for A.Y. 2024-25. Since his total income (i.e., ₹ 18,500) is less than the basic exemption limit, there would be no liability to income-tax for A.Y. 2024-25.

7. Journal of Technologies Ltd.

(₹ in crores)

			Dr.	Cr.
(1)	Loan Funds	Dr.	600	
	Current Liabilities	Dr.	800	
	Provision for Depreciation	Dr.	800	
	To Property, Plant and Equipment			1,000
	To Current Assets			1,000
	To Profit and Loss (Balancing Figure)			200
	(Being division Mobiles along with its assets and liabilities sold to Mobize Ltd. for ₹ 50 crores)			

Note:

(1) In the given scenario, this demerger will meet the definition of common control transaction. Accordingly, the transfer of assets and liabilities will be derecognized and recognized as per book value and the resultant loss or gain will be recorded in the profit and loss in the books of demerged entity (Technologies Ltd).

Technologies Ltd.

Balance sheet after reconstruction

(₹ in crores)

ASSETS	Note No.	Amount
Non-current assets		
Property, Plant and Equipment		50
Current assets		
Other current assets		400
		450
EQUITY AND LIABILITIES		
Equity		
Equity share capital (of face value of ₹ 10 each)		50

Other equity (Surplus)	1	350
Liabilities		
Current liabilities		
Current liabilities		50
		450

Notes to Accounts

		(₹ in crores)
1.	Other Equity	
	Surplus (350-200)	150
	Add: Capital Reserve on reconstruction	200
		350

Notes to Accounts: Consequent on transfer of Division Mobiles to newly incorporated company Mobize Ltd., the members of the company have been allotted 2 crore equity shares of ₹ 10 each at a premium of ₹ 15 per share of Mobize Ltd., in full settlement of the consideration in proportion to their shareholding in the company.

Balance Sheet of Mobize Ltd.

(₹ in crores)

ASSETS	Note No.	Amount
Non-current assets		
Property, Plant and Equipment (1000-800)		200
Current assets		
Other current assets		1,000
		1,200
EQUITY AND LIABILITIES		
Equity		
Equity share capital (of face value of ₹ 10 each)	1	20
Other equity	2	(220)
Liabilities		
Non-current liabilities		
Financial liabilities		
Borrowings		600

Current liabilities		
Current liabilities		800
		1,200

Notes to Accounts

		(₹ in crores)
1.	**Share Capital**:	
	Issued and Paid-up capital	
	2 crore Equity shares of ₹ 10 each fully paid up	20
	(All the above shares have been issued for consideration other than cash, to the members of Technologies Ltd. on takeover of Division Mobiles from Technologies Ltd.)	
2.	**Other Equity**:	
	Securities Premium	30
	Capital reserve [50- (1,200 – 1,400)]	(250)
		(220)

Working Note:

In the given case, since both the entities are under common control, the accounting has been done considering the following:

(a) All assets and liabilities will be recorded at book value.

(b) Identity of reserves to be maintained.

(c) No goodwill will be recorded.

(d) Securities issued will be recorded as per the nominal value.

CASE STUDY 20

CA Arvind Kapoor, the founder of Kapoor & Co., is a member of the Institute of Chartered Accountants of India who initially set up his practice in Delhi. Kapoor & Co. has rich experience of more than 35 years in almost every field and served a diverse clientele from individual taxpayers to conglomerates. Their audit approach is pragmatic, relying on a risk-based audit methodology, built on extensive planning and client input, and is fully supported by the latest technology and tools. As a result, the firm's audit practice has grown continuously and has earned specialization in core areas like direct taxation, indirect taxation, internal audit etc.

CA Arvind Kapoor, CA Rajesh Dhamija, CA Piyush Makkar and CA Gaurav Satija are four partners of the firm. They all are specialized in their own niche. They all met at a common event and decided to start their own firm. With their combined efforts and dedication, firm has accumulated an enormous amount of knowledge capital that has been built with passing of every year. This has resulted in association of various valuable clients with the firm.

One of such valuable clients is Vallabh Cotton Limited which is a listed company. Vallabh Cotton Limited is leading manufacturer of cotton. There are some issues going on in the company in respect of appointment of small shareholders' director. The Company gets its all the finance related work done from CA Gaurav Satija. When management discussed this matter with CA Gaurav Satija, he praised work of his partner CA Rajesh Dhamija who is an expert in company law matters & has been practising in this area since 15 years. Hence, management of Vallabh Cotton Limited approached CA Rajesh Dhamija for seeking advice on appointment of small shareholders' director and appointment of woman director in the company. Company has 10,00,000 equity shares of ₹ 10 each. Company has 500 small shareholders. Majority (400) of the small shareholders want to appoint Mr. Brijesh as a director as their representative on the Board of directors of the said company. Mr. Brijesh already holds 10,000 equity shares in the said company.

One sister concern of Vallabh Cotton Limited is Aggarsain Spinners Private Ltd. Earlier Aggarsain Spinners Private Ltd. was in business of trading of yarns. Now, gradually the Company wants to go forward in the area of manufacturing as well. Last year, the company had made capital investment in construction of building. This year, the company purchased machinery on 1st April 2023 for ₹ 10 crore. The Company had paid from their own funds 30% and balance 70% by availing loan facility from Synditop bank @ 12% per annum. The machine

was required for extension of business of company and was put to use into effective production on 1st February, 2024. The accountant of Company wants to take advice from CA Arvind Kapoor who is specialised in direct taxation regarding amount of depreciation that can be claimed by the company under the Income-tax Act.

The management of company also wants to discuss with CA Arvind Kapoor regarding applicability of TDS provisions under Income Tax Act on the following payments made for job work (excluding material cost) to Khushi Ltd for the financial year 2023-24 towards work done under different contracts.

Contract no.	Date of payment	Amount (₹)
1	15.05.2023	22,000
2	04.06.2023	15,000
3	08.07.2023	23,000
4	09.09.2023	25,000
5	26.01.2024	18,000

Company claims that it is not liable to deduction of tax at source. The company is seeking advice from CA Arvind Kapoor on implications of TDS.

The partners and staff of Kapoor & Co usually meet on every Saturday over coffee and discuss topics requiring deliberations. Such exercise makes their staff updated as well. In one such meeting, they discussed issues related to blocked input tax credit and credit admissible under GST Law. In this meeting, they also discussed about remedy that would be available if incorrect input tax credit is taken. All of a sudden, CA Piyush Makkar, expressed his willingness to handle a renowned client, IGT Private Limited, having good volume of turnover.

IGT Private Limited is in business of manufacturing of textile products. The accounts team of the Company is not much aware about GST Law. Earlier, GST work of company was being taken care by some other professional, Ryan & Co., till Jan 2024. In Feb, 2024, the proprietor of Ryan & Co. had shifted abroad. Hence, the management approached Kapoor & Co. for their GST work for which CA Piyush Makkar came forward to support. The accountant of Company has correctly taken all other input tax credit related to Company's purchases, but he was confused in respect of availing of input tax credit on following inputs purchased and input services availed in the month of February, 2024:-

Particulars	Input Tax paid (₹)
Goods purchased without invoice	40,000
Purchase of goods not to be used for business purpose	20,000

Purchase of goods from Sethi Lal & Sons (Invoice of Sethi Lal & Sons received in the month of February, 2024 but goods were received in the month of March, 2024)	28,000
Pollution control Equipment used in the factory capitalized in the books	1,50,000
Motor Lorries used for transportation of goods capitalized in the books	2,50,000
Electrical Transformers used in the factory capitalized in the books	2,25,000
Capital goods to be used as parts, purchased from supplier paying tax under the composition scheme.	25,000
Moulds and dies used in the factory	65,000
The company buys cement, tiles and avail the services of an architect for the construction of its office building	1,68,000
Total	**9,71,000**

Note: No depreciation is claimed on the GST paid on the capital goods.

I. Multiple Choice Questions

1. With reference to information given in the Table regarding payments on account of job work to Khushi Ltd., which one of the below option is correct in respect of the amount on which TDS is required to be deducted under the provisions of Income-tax Act, 1961:

   (a) TDS is not required to be deducted as each contract amount does not exceed the threshold limit

   (b) TDS is only required to be deducted on Contract 5 i.e. ₹ 18,000

   (c) TDS is required to be deducted on the whole amount i.e. ₹ 1,03,000

   (d) TDS is required to be deducted only on ₹ 3,000.

2. According to provisions of the Companies Act, 2013, a listed Company may have one Director elected by small shareholders. The provision enables the small shareholders to place their representative on the Board of Directors of a listed company so that their voice is also listened effectively. The small shareholders are entitled to give a notice to the company requiring the company to make appointment of a small shareholders' director. Whether 400 small shareholders of Vallabh Cotton Limited are in position to propose appointment of Mr. Brijesh as small shareholders' director.

   (a) Yes, the notice may be given by at least 1,000 small shareholders or 1/10th of the total number of small shareholders whichever is lower.

(b) No, the notice may be given by at least 1,000 small shareholders or 1/10th of the total number of small shareholders whichever is higher.

(c) No, the notice may be given by at least 1,000 small shareholders.

(d) Yes, the notice may be given by at least 9/10th of the total number of small shareholders.

3. Compute interest on machinery that is allowed as deduction under Income-tax Act, 1961 to Aggarsain Spinners Pvt. Ltd.

(a) ₹ 70,00,000

(b) ₹ 84,00,000

(c) 0

(d) ₹ 14,00,000

4. As management of Vallabh Cotton Limited approached CA Rajesh Dhamija for seeking advice on appointment of woman director in the company, which one of the following, he should have suggested regarding the same as per law relating to companies?

(a) That all companies need to appoint a woman director.

(b) That every listed company or every other public company having paid up share capital equal to or more than ₹ 100 crores or turnover equal to or more than ₹ 300 crores.

(c) That every listed company or every other public company having paid up share capital equal to or more than ₹ 10 crores or turnover equal to or more than ₹ 100 crores.

(d) That the requirement of a woman director is applicable only for private companies.

II. Descriptive Questions

5. Describe in the light of provisions contained in the Companies Act, 2013, whether the proposal to appoint Mr. Brijesh as a small shareholders' director can be adopted by the company and also brief the law relating to appointment of small shareholders' director. What would be your answer if Mr. Brijesh is already holding a position of Small Shareholders' Director in two companies?

6. Advise Aggarsain Spinners Private Ltd. on treatment of interest payment made on loan and depreciation allowable for the Assessment Year 2024-25. Assume that this machine is the only machine in the related block of assets. Aggarsain Spinners Private Ltd. is not opting for the concessional rate of tax u/s 115BAA.

7. Compute the Input Tax credit admissible under GST law to IGT Private Ltd. in respect to various inputs purchased/ input services availed during month of February, 2024.

ANSWERS TO THE CASE STUDY 20

I. Answers to the Multiple Choice Questions

1. (c) TDS is required to be deducted on the whole amount i.e. ₹ 1,03,000

Reason: As per Section 194C(5) of the Income-tax Act, 1961, tax has to be deducted at source where amount credited or paid or likely to be credited or paid to contractor or sub-contractor exceeds ₹ 30,000 in a single payment or ₹ 1,00,000 in aggregate during the financial year.

Therefore, in the given case, even though the value of each individual contract does not exceed ₹ 30,000, the aggregate amount exceeds ₹ 1,00,000. Hence, tax is required to be deducted at source on the whole amount ₹ 1,03,000 from the last payment of ₹ 18000 on account of which the aggregate amount exceeded ₹ 1,00,000.

2. (a) Yes, the notice may be given by at least 1,000 small shareholders or 1/10th of the total number of small shareholders whichever is lower.

Reason: As per Rule 7 of the Companies (Appointment and Qualification of Directors) Rules, 2014, the small shareholders are entitled to give a notice to the company requiring the company to make appointment of a Small Shareholders' Director. The notice shall be given by at least –

1000 small shareholders; or

1/10th of the total number of small shareholders,

whichever is lower.

3. **(d)** ₹ 14,00,000

Reason: As per proviso to section 36(1)(iii), interest paid in respect of capital borrowed for acquisition of an asset for the period beginning from the date of borrowing of loan for acquiring the asset till the date on which such asset is first put to use is not allowable as deduction. Therefore, interest @ 12% p.a. for a period of 2 months from 1st February, 2024 to 31st March, 2024 on ₹ 7crores is allowable as deduction under Income-tax Act, 1961.

4. **(b)** That every listed company or every other public company having paid up share capital equal to or more than ₹ 100 crores or turnover equal to or more than ₹ 300 crores.

Reason: Rule 3 of the Companies (Appointment and Qualification of Directors) Rules, 2014 provides the following classes of companies shall appoint at least one woman director:

1) every listed company,

2) every other public company having-

   a. paid up share capital of ₹ 100 crores rupees or more or

   b. turnover of ₹ 300 crore rupees or more.

II. Answers to the Descriptive Questions

5. **Small Shareholders' Director:** The provisions relating to appointment of directors by small shareholders are contained in section 151 of the Companies Act, 2013 read with Rule 7 of the Companies (Appointment and Qualification of Directors) Rules, 2014.

The legal position

1. The provisions contained in section 151 read with Rule 7 are applicable to listed companies only.

2. The small shareholders are entitled to give a notice to the company requiring the company to make appointment of a Small Shareholders' Director. The notice shall be given by at least –

   i. 1000 small shareholders; or

   ii. 1/10th of the total number of small shareholders,

   whichever is lower.

3. The notice shall be given at least fourteen days before the meeting and should be signed by all the small shareholders proposing the appointment of small shareholders' director.

4. A person shall not hold the position of small shareholders' director in more than 2 companies at the same time.

Facts of the case and analysis

In the given case, Vallabh Cotton Limited is a listed company. Some small shareholders have given a notice to the company requiring the company to appoint a Small Shareholders' Director.

The small shareholders eligible to give notice for appointment of Small Shareholders' Director shall be –

a) 1,000 small shareholders ; or

b) 1/10th of 500, i.e. 50 small shareholders,

whichever is lower.

Since lower of 1,000 and 50 is 50, the notice for appointment of Small Shareholders' Director has to be given by at least 50 small shareholders.

Conclusions

As in the given case, 400 of the small shareholders are interested in appointing small shareholders' director, the company shall adopt the procedure given in Rule 7 for appointment.

Neither section 151 nor Rule 7 state any eligibility criteria for appointment of a person as a small shareholders' director to be a small shareholder himself or not. Thus, Mr. Brijesh may be appointed as a Small Shareholders' Director i.e. even he has 10,000 equity shares in the company, it does not affect his appointment.

If Mr. Brijesh already holds position of Small Shareholders' Director in 2 companies, then, he cannot be appointed as a small shareholders' director in Vallabh Cotton Limited.

6. (i) Interest on term loan for purchase of machinery

As per proviso to section 36(1)(iii), interest paid in respect of capital borrowed for acquisition of an asset for the period beginning from the date of borrowing of

loan for acquiring the asset till the date on which such asset is first put to use is not allowable as deduction.

Interest for such period has to be capitalised, by adding the same to the cost of the asset. Therefore, interest @12% p.a. for a period of 10 months from 1st April, 2023 to 31st January, 2024 on ₹ 7 crores, being the amount of loan, has to be capitalised.

Particulars	Amount (₹)
Cost of machinery	10,00,00,000
Add: Interest [12% x 10/12 x ₹ 7,00,00,000]	70,00,000
Actual Cost of machinery	**10,70,00,000**

Interest @ 12% for two months (February, 2024 & March, 2024) ₹ 14,00,000 after the asset put to use is allowable as deduction under section 36(1)(iii) [12% x 2/12 x ₹ 7,00,00,000]

(ii) Depreciation

Particulars	Amount (₹)
Since the machinery is put to use for less than 180 days in the previous year 2023-24, the depreciation would be restricted to 50% of the amount calculated at the prescribed percentage of 15%. Therefore, depreciation is 50% x [15% x ₹ 10,70,00,000]	80,25,000
Additional depreciation of 20%, for being engaged in the manufacturing of cotton and purchasing new machinery, would also be restricted to 50% of the amount calculated.	
Therefore, additional depreciation= 50% x [20% x 10,70,00,000]	1,07,00,000
Total Depreciation	**1,87,25,000**

However, balance additional depreciation of ₹ 1,07,00,000 shall be allowed under section 32(1)(iia) in the immediately succeeding previous year.

7. Computation of input tax credit admissible to IGT Private Ltd. in respect to various inputs purchased during the month of February, 2024

S. No.	Particulars	Input Tax Credit (₹)
1	Goods purchased without invoice (working note 1)	nil

2	Purchase of Goods not to be used for business purpose (working note 2)	nil
3	Purchase of Goods from Sethi Lal & Sons (Invoice of Sethi Lal & Sons received in the month of February, 2024 but goods were received in the month of March, 2024) (working note 3)	nil
4	Pollution control Equipment used in the factory (working note 4)	1,50,000
5	Motor Lorries used for transportation of goods (working note 6)	2,50,000
6	Electrical Transformers used in the factory (working note 4)	2,25,000
7	Capital goods used as parts purchased from supplier who paid tax under the composition scheme and the tax has not been collected from IGT Private Limited (working note 5)	nil
8	Moulds and dies used in the factory (working note 4)	65,000
9	The company buys cement, tiles and avails the services of an architect for the construction of its office building (working note 7)	nil
	Eligible ITC	**6,90,000**

Working Notes-

1) No Input tax credit will be available since IGT Private Limited is not in possession of valid tax paying document.

2) A registered person shall be entitled to take the input tax credit on goods which are used or intended to be used in the course or furtherance of his business. Since the company has purchased the goods for non-business purpose, hence no credit will be available on such purchases.

3) Input tax credit is admissible only when registered person has received such goods. Hence, when goods received in the month of March, 2024 input tax credit cannot be taken in the month of February, 2024.

4) Input tax credit is available on the goods which are used or intended to be used in the course or furtherance of business. Hence input tax credit is available on the following:

   a) Electrical Transformers

   b) Moulds and dies

   c) Pollution control Equipment

5) As per Section 17(5)(e) of the CGST Act, 2017, input tax credit shall not be available in respect of goods or services or both on which tax has been paid under sec 10 of the CGST Act, 2017. Thus, no ITC shall be allowed of tax paid under composition scheme by the supplier.

6) In respect of motor vehicle used for the purpose of transportation of goods, the same is not covered under the ambit of blocked credit, hence ITC shall be admissible in respect of motor vehicles.

7) As per Section 17(5)(c) of the CGST Act, 2017,, ITC is blocked on input or input service relating to construction activity like construction of office building, factory building etc.

CASE STUDY 21

Cycles India Ltd. (CIL) manufactures cycles for both adults and children. Given below is information about cycles made for children–

Particulars	Traditional	Activity Based
	CVP Analysis	CVP Analysis
Monthly Demand and Production	20,000	20,000
Selling Price	16,000	16,000
Variable Cost per unit	15,000	15,000
Fixed Cost p.m. (as identified under each cost system)	20,00,000	16,00,000
Number of set ups		800
Cost per set up		500

Fixed costs of ₹ 20,00,000 per month under Traditional CVP analysis are those that do not vary with respect to volume. Following an Activity Based Costing study, fixed cost that do not vary as per volume or any other cost driver has been identified to be ₹ 16,00,000 per month. The study revealed a milling machine is used to cut metal into steer support. Production of these steer support takes place in batches of 25 units.

Once a batch for children's cycle is finished, the next batch would be that for adult cycles. Therefore, after each batch there would be a set-up change. If 20,000 children's cycles have to be produced, number of set-ups required = 20,000 steer support / 25 per batch = 800 set-ups. Each set-up costs ₹ 500, comprising of material costs like change of oil, jig etc. This cost was previously pooled together with fixed cost under traditional CVP analysis.

The plant manager would like to keep the number of set-ups minimum since they reduce the capacity of the machine. Suppose that at any time the milling machine can be used to produce batches of either adult cycle or children cycles. He proposes to increase the batch size of children's steer support to 100 units in one batch. The number of set-ups will reduce from 800 (20,000 units / 25 units) to 200 (20,000 units / 100 units). Due to larger batch production, additional inventory storage area that would be required to store that will cost the company ₹ 100,000 per month extra.

The annual manufacturing capacity at CIL is currently 10,00,000 cycles. The demand for cycles has been increasing within India. Hence, the management wants to increase the annual

manufacturing capacity to 18,00,000 cycles. Due to increased production requirements, CIL bought additional machinery for the production line. All assets were purchased by account payee cheque. Below are the details of the plant and machinery

Sr. No.	Particulars	₹
1	Opening WDV for plant and machinery on 1.4.2023 (WDV as on 31.3.2023 after reducing depreciation for PY 2022-23	10,00,00,000
2	New plant and machinery purchased and put to use on 30.6.2023	5,00,00,000
3	New plant and machinery purchased and put to use on 31.12.2023	5,00,00,000

Due to increased production requirements, the need for storage space both for raw materials and finished goods has increased manifold. Storage costs at CIL's factory site that manufactures cycles is very expensive. Hence, the management wants to consider the option of implementing an effective Just In Time (JIT) system for material procurement and production in order to reduce on the need for additional storage area. Under JIT, the materials will be delivered directly to the machine on the shop floor. Also, JIT being a pull system initiated by the customer, once the cycle is manufactured it will be send out for delivery to the customer immediately. During the meeting, as the management accountant, you point out that the JIT system needs to be sufficiently supported by an effective back-flushing system that will account for the components / materials used in the production process. Given the large production volumes and fast turnaround times required under JIY, back-flushing system is the ideal solution to account for components.

CIL has recently decided to start selling cycles to professional cyclists within India. International exposure and increased availability of facilities has improved career prospects for professional cyclists. Yet, at present this market segment is at its nascent stage. The company is also foraying into this segment for the first time. CIL has opened a small dealership shop in Mumbai specifically to sell these high value professional cycles.

On March 31, 2024 it imported its first batch of 100 professional cycles from a company in France. The details of expenses incurred at the dealership in Mumbai are given below:

Sr. No.	Details	Amount (₹)
1	Cost of purchases (based on supplier's invoice)	50,00,000
2	Handling costs relating to imports	6,00,000
3	Salaries of accounting staff at the dealership	5,00,000

4	Sales commission paid to sales agents	8,00,000
5	After sales warranty costs	4,00,000
6	Import duties	2,50,000
7	Freight expenses	2,50,000
8	Insurance of purchases	1,00,000
9	Brokerage commission paid to indenting agents	1,00,000

These 100 professional cycles are held in stock as on March 31,2024 which is the end of the financial year. The current market price for these cycles is ₹64,000 per unit. CIL also has a firm sales contract with a smaller cycle dealership for 30 cycles at ₹65,000 per unit, which cannot be settled yet. Estimated incremental selling cost is ₹2,000 per unit for all cycles.

The manager of the dealership for imported cycles is of the opinion that at a selling price of ₹64,000 per imported professional cycle, CIL will be unable to earn any profit margin at all. The same is true even with the firm order to 30 cycles for which the sale price is ₹65,000 per cycle. She wishes to increase the selling price to ₹85,000 per cycle. Her annual performance is based on the profits that this dealership venture generates. Hence, she is very insistent on increasing the selling price of the imported cycles.

I. Multiple Choice Questions

1. Given the information about CIL's plant and machinery, the total amount of depreciation that can be claimed as per Income-tax Act, 1961 for the A.Y. 2024-25. The company does not opt for Section 115BAA/115BAB.

   (a) ₹ 2,62,50,000

   (b) ₹ 4,12,50,000

   (c) ₹ 3,00,00,000

   (d) ₹ 3,75,00,000

2. Determine in which of the following cases should labour cost not be factored into the cost of set up?

   (a) Cost of using temporary labour hired for particular set up

   (b) Cost of outsourcing set up activities.

   (c) Cost of using permanent labour who are otherwise idle

(d) If additional labour supplies are unavailable in the short term and where no further overtime working is possible, cost of using permanent labour who are engaged in the production process.

3. Which of the following is not a pre requisite for an effective JIT system?

(a) Varying demand patterns

(b) Lesser set up time

(c) Total quality management

(d) Multi skilled labour force

4. Which of the following is not a problem of using back-flushing in JIT system?

(a) The production reporting has to be accurate

(b) The scrap reporting has to be accurate

(c) Unless the software allows picking and back-flushing systems to co-exists, lot tracing is not possible

(d) Back-flushing requires no data entry of any kind until a finished product is completed.

5. Which of the following factors will make the customer more sensitive towards the price of the professional imported cycle?

(a) Higher perceived quality of the cycle

(b) Practical difficulty in comparison of the imported professional cycle with any alternatives available domestically due to lack of awareness

(c) Imported professional cycles being unique can give users recognition among peers

(d) High proportion of expenditure (product cost) to the customer income

II. Descriptive Questions

6. (i) Find the break-even point per month and profit per month under the traditional CVP method and the Activity Based CVP method when the batch size of manufacturing children's steer support is 25 units per batch.

(ii) Analyse the impact on BEP (units per month) and profits per month when the batch size of manufacturing children's steer support increases from 25 units to 100 units per batch.

(iii) Explain How can the number of set-ups and cost of each set-up impact flexibility of the milling machine?

7. (i) Evaluate which of the costs pertaining to the 100 imported cycles are allowed to be included in the cost of inventory in the books of CIL.

(ii) Calculate the Net Realizable Value (NRV) of the inventory of CIL relating to these 100 imported cycles?

(iii) Calculate the value of inventory of the 100 imported cycles as of March 31, 2024.

ANSWERS TO THE CASE STUDY 21

I. Answers to the Multiple Choice Questions

1. (b) ₹ 4,12,50,000

Reason: Working of depreciation for A.Y. 2024-25

Sr. No.	Particulars		₹
1	Normal depreciation		
	(a) 15% x ₹ 15 crores (Opening WDV of plant and machinery of ₹ 10 crores + new machinery acquired and put to use on 30.6.2023 i.e., more than 180 days of ₹ 5 crores)	2,25,00,000	
	(b) 15% x 50%x ₹ 5 crores (Since new machinery of ₹ 5 crores acquired and put to use on 31.12.2023 i.e., less than 180 days, depreciation would be restricted to 50% of 15%)	37,50,000	
			2,62,50,000
2	Additional depreciation		
	(a) 20% x ₹ 5 crores (Machinery acquired and put to use on 30.6.2023 i.e., more than 180 days)	1,00,00,000	
	(b) 20% x 50% x ₹ 5 crores (Since new machinery of ₹ 5 crores acquired and put to use on 31.12.2023 i.e., less than 180 days, additional depreciation would be restricted to 50% of 20%)	50,00,000	
			1,50,00,000
3	Total depreciation for A.Y. 2024-25		4,12,50,000

Note: As per the third provisio of section 32(1)(ii), the balance additional depreciation being ₹ 50,00,000 (50% x 20% x ₹ 5 crores) would be allowed as deduction in A.Y. 2025-26 provided CIL does not opt for the provisions of section 115BBA.

2. (c) Cost of using permanent labour who are otherwise idle

Reason: The cost of permanent labour used for set-up, who are otherwise idle, would not be included in set-up costs since the salaries paid to them have to be incurred anyway, it is a sunk cost.

The cost of temporary labour hired for particular set-up or cost of outsourcing of set-up activities would be included in set-up costs as these are expenses incurred for the purpose of set up.

Where permanent labour is used for set-up, who are otherwise fully engaged in the production process and additional labour supplies are unavailable in the short term, and where no further overtime working is possible, the opportunity cost of labour (for example lost contribution) needs to be considered along with the hourly labour rate.

3. (a) Varying demand patterns

Reason: varying demand patterns are not helpful in JIT systems, the demand should be predictable since the company operates without inventory.

Lesser set up time that makes batch production economical. Total quality management that enables quick elimination of defects. Multi skilled labour force can perform different activities including repairs and maintenance, which reduces idle time.

4. (d) Back-flushing requires no data entry of any kind until a finished product is completed.

Reason: This is actually an advantage of using back-flushing in JIT environment.

5. (d) High proportion of expenditure (product cost) to the customer income.

Reason: Where the expenditure on account of the purchasing the product is high in proportion to the customer income, the customer will be more sensitive towards the price of a product.

II. Answers to the Descriptive Questions

6. (i) (a) Break-even point (units per month) and profit per month under traditional CVP analysis:

	Amount (₹)
Selling Price per unit	16,000
Variable Cost per unit	15,000
Contribution per unit	1,000
Fixed Cost per month	20,00,000
Break-even Point (per month in units)	2000
Monthly Demand (units)	20,000
Profit per month = {Monthly demand (units) × Contribution per unit} – Fixed Cost per month	1,80,00,000

(b) Break-even point (units per month) and profit per month under Activity Based CVP method. The number of units produced per batch is 25. Therefore, the number of set-ups will be 20,000 units / 25 units = 800 per month.

	Amount (₹)
Selling Price per unit	16,000
Variable Cost per unit	15,000
Contribution per unit	1,000
Fixed Cost per month (per Activity Based method)	16,00,000
Break-even Point (per month in units) = {Fixed Cost p.m. + (number of set-ups × cost per set-up)}/ Contribution p.u. = {₹ 16,00,000 + (800 × ₹ 500 per set-up)}/ ₹ 1,000 per unit = ₹ 20,00,000 / ₹ 1,000 per unit	2,000
Monthly Demand (units)	20,000
Profit per month = {Monthly demand (units) × Contribution per unit} – (Fixed Cost per month + Set-up cost per month) = (20,000 × ₹ 1,000 per unit) – (₹ 16,00,000+₹ 400,000) = ₹ 2,00,00,000 – ₹ 20,00,000	1,80,00,000

Although the BEP units and the profit per month are the same under both methods, the Activity Based method has brought forth the point that there are 800 set-ups being performed per month. This would give the management more information to work with in order to improve operations.

(ii) Break-even point (units per month) and profit per month under Activity Based CVP analysis: Batch size increased from 25 to 100 units; monthly set-ups reduce from 800 to 200 per month.

	Amount (₹)
Selling Price per unit	16,000
Variable Cost per unit	15,000
Contribution per unit	1,000
Fixed Cost per month (per Activity Based method)	17,00,000
Break-even Point (per month in units) = {Fixed Cost p.m. + (number of set-ups × cost per set-up)}/ Contribution p.u. = {₹ 17,00,000 + (200 × ₹ 500 per set-up)}/ ₹ 1,000 per unit = ₹ 18,00,000 / ₹ 1,000 per unit	1,800
Monthly Demand (units)	20,000
Profit per month = {Monthly demand (units) × Contribution per unit} – (Fixed Cost per month + Set-up cost per month) = (20,000 × ₹ 1,000 per unit) – (₹ 17,00,000+₹ 100,000) = ₹ 2,00,00,000 – ₹ 18,00,000	1,82,00,000

Analysis

It can be concluded by increasing the batch-size, the capacity of the machine can be increased. The time freed by reducing set-ups from 800 per month to 200 per month can now be used for other productin activities. Since the number of set-ups will be reduced, so will the monthly set-up costs. Even after off-setting the increase in storage cost, profits will increase by ₹ 200,000 per month (₹ 1,80,00,000 - ₹ 1,82,00,000 per month). Consequently, the break-even point has reduced from 2,000 units per month to 1,800 units per month. This reduction is due to the savings in the overall set-up costs due to the lower number of set-ups.

(iii) Set-ups reduce the production utility of a machine. A lower number of set-ups or lower set-up time can improve the utilization of the machine. This also gives the company flexibility to keep changing the batches produced at the milling machine to cater to children's cycles and adult cycles as per its requirement. The other factor that impacts flexibility of production would be the set-up costs. The lower

the set-up costs, the higher the flexibility to change batches produced at the milling machine to cater to each type of cycle.

7. (i) As per Ind AS 2, the following costs pertaining to the 100 imported cycles are includable in the cost of inventory of books of CIL:

Details	Amount (₹)
Cost of purchases (based on supplier's invoice)	50,00,000
Handling costs relating to imports	6,00,000
Import duties	2,50,000
Freight expenses	2,50,000
Insurance of purchases	1,00,000
Brokerage commission paid to indenting agents	1,00,000
Total cost to be included in inventory	63,00,000

Hence, the total cost includable in the cost of inventory of the 100 imported cycles is ₹ 63,00,000. Per unit cost would therefore be ₹ 63,000 per cycle.

Salaries of accounts department, sales commission, and after sale warranty costs *are not considered to be the cost of inventory. Therefore, they are not allowed by Ind AS 2 for inclusion in cost of inventory and are expensed off in the profit and loss account.*

(ii) Calculation of NRV of the inventory of CIL relating to these 100 imported cycles

While performing the NRV test, the NRV of 30 cycles to be sold to the other cycle dealership under a firm contract will be ₹ 63,000 per cycle (Selling price per cycle ₹65,000 per cycle less additional selling expenses ₹ 2,000 per cycle). The cost of inventory per cycle as calculated in (i) above is also ₹ 63,000 per cycle. Therefore, no adjustment is required for the value of the 30 cycles under firm contract.

NRV of the remaining 70 cycles is ₹ 62,000 per cycle (market price of ₹ 64,000 per cycle less additional selling expenses ₹ 2,000 per cycle).

(iii) The cost of inventory per cycle as calculated in (i) above is ₹ 63,000 per cycle for 30 cycles. Therefore, these 70 cycles have to be valued at NRV of ₹ 62,000 per cycle which is lower than the cost of ₹ 63,000 by ₹ 1,000 per cycle. Therefore, CIL has to write down the value of inventory for these 70 cycles by ₹ 70,000 (70 cycles x write down of ₹ 1,000 per cycle).

Value of inventory of 100 cycles on March 31,2024 lower of cost or NRV

Sr. No.	Details	Amount (₹)
1	*Value of 30 cycles under firm contract 30 cycles x ₹63,000 per cycle)*	18,90,000
2	Value of balance 70 cycles at NRV 70 cycles x ₹ 62,000 per cycle)	43,40,000
3	Total inventory value	62,30,000

The cost of the imported cycles is ₹ 63,00,000 whereas the NRV is ₹ 62,30,000. Hence, the inventory will be valued at ₹ 62,30,000.

CASE STUDY 22

Mr. Manish, registered under GST, is a Chartered Accountant, resident of Pune. Manish has received the technical consultancy services for his business from his brother - Gaurav who is well settled (financially independent) in Canada. His brother did not wish to charge any consideration from him for the same, but on insistence of Manish, he charged ₹ 20,000 (consideration in Indian rupees) from him. However, he charges ₹ 2,00,000 (consideration in Indian rupees) from his other clients in India for the same work.

Further, one of its clients, M/s Gupta Sweets, a store located and registered under GST in Maharashtra, had come out with big discount offer at the time of Diwali on various gift items.

In order to attract more customers, it had decided to supply a gift pack containing 5 packets of Ladila's Namkeen (200 gram each) taxable @ 12%, 1 packet of Roasted Smoked Almonds (100 gram) taxable @ 18%, 1 packet of Cournville Chocolate (50 mg) taxable @ 28% and 1 bottle of Teal Fresh Juice (1 litre) taxable @ 18% in a single basket for a single price of ₹ 600 (GST inclusive).

Mr. Manish provides management consultancy and internal audit services to his clients. During 2023, looking to the growing needs of his clients to invest in the stock markets, he also advised them on Portfolio Management Services whereby he managed portfolios of some of his clients. Looking at his expertise in financial management, Mr. Jaman, a student of Chartered Accountancy course, is very much impressed with his knowledge.

He approached Mr. Manish to take guidance on some topics of financial management subject related to his course. Mr. Manish, on request, decided to spare some time and started providing classes to Mr. Jaman along with some other aspirants for 3 days in a week and for 1 hours in a day. However, he had not taken any specific permission for such private tutorship from the Council.

Mr. Manish was appointed as the internal auditor of Kapur Pharma Ltd., a company engaged in manufacturing of medicines based at Pune, Maharshtra, as the company was required to appoint internal auditor as per statutory provisions given in the Companies Act, 2013. The company is registered under GST in the state of Maharashtra.

The company was founded in 2014 by Dr. Rajesh Kapur, a physician and entrepreneur. Dr. Kapur saw a need for affordable, high-quality medicines in India, and he founded Kapur Pharma Ltd. to meet that need. The company has grown rapidly since its founding, and it now employs over 200 people. Dr. Rajesh Kapur is also running a health clinic naming Kapur Health Clinic. Health Clinic offers a membership program where individuals or families can subscribe to access a variety of healthcare services for a monthly or annual fee. The subscription fee covers a range of preventive care, primary care, and wellness services, providing members with convenient and affordable access to healthcare. BMK & Co. was appointed to conduct statutory audit of Kapur Pharma Ltd. The engagement partner of the firm, Mr. Rajan asked Mr. Manish to provide direct assistance to him regarding evaluating significant accounting estimates by the management and assessing the risk of material misstatements.

He also sought his direct assistance in assembling the information necessary to resolve exceptions in confirmation responses with respect to external confirmation requests and evaluation of the results of external confirmation procedures.

Kapur Pharma Ltd. was considering its projects namely 'Dehradun Plant' and 'Borsad Plant', respectively, for establishing its manufacturing units, for which it took assistance of Mr. Manish for providing project appraisal, based on following information:

Project	Expected NPV (₹)	Standard deviation (₹)
Dehradun Plant	2,44,00,000	1,80,00,000
Borsad Plant	4,50,00,000	2,40,00,000

Also, Mr. Manish for asked to provide a brief that how project appraisal is done under inflationary conditions, as the aforesaid projects faced the similar situation.

Kapur Pharma Ltd. has 200 employees, who are each entitled to five working days of paid sick leaves or each year. Unused sick leave may be carried forward for one calendar year. Sick leave is taken first out of the current year's entitlement and then out of any balance brought forward from the previous year (LIFO basis).

At 31st March, 2024, the average unused entitlement is two days per employee. The entity expects, on the basis of experience that is expected to continue, that 184 employees will take no more than five days of paid sick leaves in 2024-2025 and that the remaining sixteen employees will take an average of six and a half days each.

The entity expects that it will pay an additional twelve days of sick pay as a result of the unused entitlement that has accumulated at 31st March, 2024 (one and a half days each, for sixteen employees).

Further, the company has a post-employment medical plan which will reimburse 15% of an employee's post-employment medical costs if the employee leaves after more than ten and less than twenty years of service and 40% of those costs if the employee leaves after twenty or more years of service.

The Assessing Officer within his jurisdiction surveyed the primary business place of Kapur Pharma Ltd. at 11 p.m. for the purpose of collecting information which may be useful for the purposes of the Income-tax Act, 1961. The place is kept open for business every day between 10 a.m. and 12 midnight. He impounded and retained in his custody, books of account and other documents inspected by him, after recording his reasons for doing so, for 12 days.

Kapur Pharma Ltd is producing medication products and can be called high volume based production environment. There are several different automated production machines located in the plant, through which production of medicines is accomplished and fulfilled the demands. Plant operates in double shift a day each consisting of 8 hours with 25 minutes' lunch break and tea break of 10 minutes. Following data pertains to automated machine 'M-200'.

M-200

19 April 2024, Wednesday

Breakdown, repair and start up time (unplanned)	90 minutes
Standard cycle time	2.5 minutes *per tablet*
Quality loss due to scrap, rework, and rejection	40 tablets
Total quantity produced	280 tablets

I. Multiple Choice Questions

1. The place of supply and value of supply of the event management services received from his brother – Gaurav are:

   (a) Pune and ₹ 20,000

   (b) Canada and nil, since place of supply is outside India.

   (c) Pune and ₹ 2,00,000 since brother is a related person.

   (d) Pune and nil, since it is not a supply as his brother is not a related person.

2. Calculate the amount of GST payable in respect of supply of a gift pack in the form of a single basket by M/s Gupta Sweets.

   (a) ₹ 108

   (b) ₹ 168

   (c) ₹ 92

   (d) ₹ 131

3. Whether Mr. Manish is guilty of professional misconduct in providing private tutorship to Mr. Jaman along with some other aspirants for 3 days in a week and for 1 hours in a day in the absence of specific approval?

   (a) Mr. Manish is not guilty of professional misconduct as he is teaching within prescribed hours i.e. not exceeding 25 hours a month as per Regulation 192A.

   (b) Mr. Manish is not guilty of professional misconduct as he is teaching within prescribed hours i.e. not exceeding 25 hours a month as per Regulation 190A.

   (c) Mr. Manish is guilty of professional misconduct as he has not obtained specific permission for the same.

   (d) Mr. Manish is not guilty of professional misconduct as he is teaching within prescribed hours i.e. not exceeding 25 hours a week as per Regulation 190A.

4. What type of business model is exemplified by Kapur Health Clinic's offering of a membership program for accessing healthcare services?

   (a) Retail Model

   (b) Franchise Model

   (c) Subscription Model

   (d) Consultancy Model

5. Which of the following statements is correct in respect of the survey conducted at the business place of Kapur Pharma Ltd.?

   (a) The Assessing Officer's action in entering the business place of Kapur Pharma Ltd. at 11 p.m. and impounding books of account and documents inspected by him is in order

   (b) The Assessing Officer's action in entering the business place of Kapur Pharma Ltd. at 11 p.m. is not in order, since he can enter the business place only after sunrise but before sunset

   (c) The Assessing Officer's action in entering the business place of Kapur Pharma Ltd. at 11 p.m. and in impounding books of account and documents inspected by him are not in order, since he can enter the business place only after sunrise but before sunset and he does not have the power to impound books of account under section 133B

   (d) The Assessing Officer's action in entering the business place of Kapur Pharma Ltd. at 11 p.m. is in order but impounding books of account and documents inspected by him is not in order, since he does not have the power to impound books of account under section 133B

II. Descriptive Questions

6. In connection with consideration for Borasad and Dehradun Plant by Kapur Pharma Ltd. Analyse the following -

   (i) Which project would have been recommended by Mr. Manish? Explain whether his opinion will change, if coefficient of variation is used as a measure of risk. Which measure is more appropriate in this situation and why?

   (ii) Provide a brief information project appraisal under inflationary conditions as would have been provided by Mr. Manish.

7. (i) Comment whether the entity would require to recognize any liability in respect of employee leaves

(ii) State the benefit to be attributed for the employee service for the last 20 years, 10 and 20 years and within 10 years be measured.

8. Referring to the data given of Automated Machnine M-200, your are required to calculate OEE.

ANSWERS TO THE CASE STUDY 22

I. Answers to the Multiple Choice Questions

1. (a) Pune and ₹ 20,000

Reason: Since technical consultancy service is not a specified service under sub-section (3) to (13) of section 13 of the IGST Act , 2017, place of supply will be governed by section 13(2) of the IGST Act, 2017 [Default provision] which provides that the place of supply of services except the specified services shall be the location of the recipient of services. Thus, place of supply of technical consultancy services is location of Manish, i.e. Pune.

Section 7(1) of the CGST Act, 2017 provides that supply includes importation of services, for a consideration whether or not in the course or furtherance of business. Thus, importation of technical consultancy service with consideration amounts to supply under GST.

Persons including legal person are deemed as related persons if they are members of the same family. Further, Section 2(49) of the CGST Act, 2017 provides that family means, —

(i) the spouse and children of the person, and

(ii) the parents, grand-parents, brothers and sisters of the person if they are wholly or mainly dependent on the said person.

Since brother is well settled (financially independent) in Canada, he does not amount to member of the family.

Section 15(1) of the CGST Act, 2017 provides that the value of a supply of goods or services or both shall be the transaction value, which is the price actually paid or payable for the said supply of goods or services or both where the supplier and the recipient of the supply are not related and the price is the sole consideration for the supply. Thus, value of supply of event management services is ₹ 20,000.

2. (d) ₹ 131

Reason: As per Section 8 of the CGST Act, 2017,

The tax liability on a composite or a mixed supply shall be determined in the following manner, namely:-

(a) a composite supply comprising two or more supplies, one of which is a principal supply, shall be treated as a supply of such principal supply; and

(b) a mixed supply comprising of two or more supplies shall be treated as supply of that particular supply that attracts highest rate of tax

In order to determine whether the supplies are 'composite supply' or 'mixed supply', one needs to determine whether the supplies are naturally bundled or not naturally bundled in ordinary course of business. The concept of 'naturally bundled' supplies is emanating from the definition of 'composite supply'.

Accordingly, the supply which is not naturally bundled and not supplied in ordinary course of business is a mixed supply that attracts highest rate of tax.

Here, in the gift pack highest rate of tax is of Cournville Chocolate (50 mg) taxable @ 28% and the price of ₹ 600 is GST inclusive. Accordingly, GST payable would be ₹ 600×28/128 = ₹ 131 (rounded off)

3. (d) Mr. Manish is not guilty of professional misconduct as he is teaching within prescribed hours i.e. not exceeding 25 hours a week as per Regulation 190A.

Reason: The Council has passed a Resolution under Regulation 190A granting general permission (for private tutorship, and part-time tutorship under Coaching organization of the Institute) and specific permission (for parttime or full-time tutorship under any educational institution other than Coaching organization of the Institute). Such general and specific permission granted is subject to the condition that the direct teaching hours devoted to such activities taken together should not exceed 25 hours a week in order to be able to undertake attest functions.

4. (c) Subscription Model

Reason: The correct answer is C) Subscription Model. Kapur Health Clinic's membership program, where individuals or families can subscribe to access healthcare services for a monthly or annual fee, aligns with the subscription model. In this model, customers pay a recurring fee to access a service or product regularly over a specified period. In this case, subscribers pay a fee to access a variety of healthcare services provided by the clinic, including preventive care, primary care, and wellness services, on an ongoing basis. Therefore, the subscription model accurately describes the business model of Kapur Health Clinic's membership program.

5. **(a)** The Assessing Officer's action in entering the business place of Kapur Pharma Ltd. at 11 p.m. and impounding books of account and documents inspected by him is in order

Reason: Section 133A of the Income-tax Act, 1961,

The income-tax authority may enter any place of business or profession mentioned above only during the hours at which such place is open for the conduct of business or profession and in the case of any other place, only after sunrise and before sunset.

An income-tax authority may impound and retain in his custody for such period as he thinks fit any book of account or other documents inspected by him after recording reasons for doing so. However, the income tax authority cannot retain in his custody such books of account etc. for a period exceeding 15 days (excluding holidays) without obtaining the approval of the Principal Chief Commissioner or Chief Commissioner or Principal Director General or Director General or the Principal Commissioner or Commissioner or Principal Director or Director, as the case may be.

II. Answers to the Descriptive Questions

6. **(i)** **(a)** On the basis of standard deviation project Dehradun Plant be chosen because it is less risky than Project Borsad Plant having higher standard deviation.

(b) CV of project Dehradun Plant = SD/ ENPV = 1,80,00,000/2,44,00,000 = 0.738

CV of project Borsad Plant = 2,40,00,000/4,50,00,000 = 0.533

On the basis of Co-efficient of Variation (C.V.) Project Dehradun Plant appears to be riskier and hence, project Borsad Plant should be accepted

(c) However, the NPV method in such conflicting situation is best because the NPV method is in compatibility of the objective of wealth maximisation in terms of time value.

(ii) Project Appraisal normally involves feasibility evaluation from technical, commercial, economic and financial aspects. It is generally an exercise in measurement and analysis of cash flows expected to occur over the life of the project. The project cash outflows usually occur initially and inflows come in the future.

During inflationary conditions, the project cost increases on all heads viz. labour, raw material, fixed assets such as equipments, plant and machinery, building

material, remuneration of technicians and managerial personnel etc. Beside this, inflationary conditions erode purchasing power of consumers and affect the demand pattern. Thus, not only cost of production but also the projected statement of profitability and cash flows are affected by the change in demand pattern. Even financial institutions and banks may revise their lending rates resulting in escalation in financing cost during inflationary conditions. Under such circumstances, project appraisal has to be done generally keeping in view the following guidelines which are usually followed by government agencies, banks and financial institutions.

(i) It is always advisable to make provisions for cost escalation on all heads of cost, keeping in view the rate of inflation during likely period of delay in project implementation.

(ii) The various sources of finance should be carefully scrutinized with reference to probable revision in the rate of interest by the lenders and the revision which could be affected in the interest-bearing securities to be issued. All these factors will push up the cost of funds for the organization.

(iii) Adjustments should be made in profitability and cash flow projections to take care of the inflationary pressures affecting future projections.

(iv) It is also advisable to examine the financial viability of the project at the revised rates and assess the same with reference to economic justification of the project. The appropriate measure for this aspect is the economic rate of return for the project which will equate the present value of capital expenditures to net cash flows over the life of the projects. The rate of return should be acceptable which also accommodates the rate of inflation per annum.

(v) In an inflationary situation, projects having early payback periods should be preferred because projects with long payback period are riskier.

Under conditions of inflation, the project cost estimates that are relevant for a future date will suffer escalation. Inflationary conditions will tend to initiate the measurement of future cash flows. Either of the following two approaches may be used while appraising projects under such conditions:

(a) Adjust each year's cash flows to an inflation index, recognizing selling price increases and cost increases annually; or

(b) Adjust the 'Acceptance Rate' (cut-off) suitably retaining cash flow projections at current price levels.

An example of approach (ii) above can be as follows:

Normal Acceptance Rate: 15.0%

Expected Annual Inflation: 5.0%

Adjusted Discount Rate: 15.0 × 1.05 or 15.75%

It must be noted that measurement of inflation has no standard approach nor is easy. This makes the job of appraisal a difficult one under such conditions.

7. **(i)** At 31st March, 2024, the average unused entitlement is two days per employee. The company expects, on the basis of experience that is expected to continue, that 184 employees will take no more than five days of paid sick leaves in 2024-2025 and that the remaining sixteen employees will take an average of six and a half days each.

The company expects that it will pay an additional twenty four days of sick pay as a result of the unused entitlement that has accumulated at 31st March, 2024 (one and a half days each, for sixteen employees).

Therefore, the company would recognize a liability equal to twenty four days of sick pay.

(ii) As per Ind AS 19, the benefit will be attributed till the period the employee service will lead to no material amount of benefits. And service in later years will lead to a materially higher level of benefit than in earlier years. Therefore, for employees expected to leave after twenty or more years, the entity would attribute benefit on a straight-line basis. Service beyond twenty years will lead to no material amount of further benefits. Therefore, the benefit attributed to each of the first twenty years is 2% (i.e. 40% divided by 20) of the present value of the expected medical costs.

For employees expected to leave between ten and twenty years, the benefit attributed to each of the first ten years is 1.5% (15 % divided by 10) of the present value of the expected medical costs. For these employees, no benefit is attributed to service between the end of the tenth year and the estimated date of leaving.

For employees expected to leave within ten years, no benefit is attributed.

8. Calculation of Planned Production Time

		Mins.
Total time		480
Less:	Planned downtime	
	tea break	10
	lunch break	25
	Planned Production Time	445

Availability Ratio = $\left\{\frac{445 \text{ mins.} - 45 \text{ mins.}}{445 \text{ mins.}}\right\} \times 100 = 89.89\ \%$

Actual Production = 140 tablets *per shift*

Standard time = 2.5 minutes

Standard Time Required = 140 units × 2.5 minutes

= 350 minutes

Actual Time Taken = 445 mins. – 45 mins.

= 400 minutes

Performance Ratio = $\left\{\frac{350 \text{ mins.}}{400 \text{ mins.}}\right\} \times 100 = 87.50\%$

Quality Ratio = $\left\{\frac{140 \text{ tab.} - 20 \text{ tab.}}{140 \text{ tab.}}\right\} \times 100 = 85.71\%$

Thus, **OEE** = Availability Ratio x Performance Ratio x Quality Ratio

= 0.8989 × 0.8750 × 0.8571 = 67.41%

CASE STUDY 23

ABCD Ltd. is a textile manufacturing company based in Surat, Gujarat, which enjoys a vintage of more than 50 years of good reputation and business. The Company was set up by Mr. Amar Dev in the 60's in a small room and as years passed by, it became such a successful and big business that now after serving domestic consumers, the Company has gone global and expanding its business across Europe and Canada through third party sales from India. Mr. Rahul Dev, grandson of Mr. Amar Dev is Managing Director of Company and has been following quite an aggressive approach in globalizing their business after graduating from college. He remains in constant touch with CA Nitin Garg, partner of Nitin Garg & Co., Chartered Accountants, and keeps on discussing with him legal compliances and procedures.

Rahul knows that the complexities in business have increased a lot particularly after advent of GST and it is imperative to diversify the ever-expanding businesses. He understands that their company is well integrated into the web of international business transactions. There is inward as well as outward flow of goods and services between India and other countries. GST impacts imports and exports too. Provisions in the GST laws seek to (i) provide a level playing field to domestic suppliers vis a vis international suppliers in case of imports and (ii) make exports more competitive. He has been discussing various provisions of GST law as will be applicable on import and export supplies w.r.t. their business, if they wish to enter the global market directly, apart from the normal customs levy.

ABCD Limited wants to expand its business and management has found a suitable site which meets its requirements. The said site is owned by one of directors of company i.e. Mr. D. However, Mr. D was unwilling to sell his prized property to the company. The company, however, offers him, in exchange, a bigger site located in an area having commercial potential. Lured by offer, Mr. D agrees to above. A property valuer (Civil engineer by profession) who is having experience of 20 years in valuing properties for commercial banks is also approached by company for arriving at value of assets involved in above deal. The valuer does not possess any other registrations or accreditations.

Rahul, in order to expand his business, also discusses with Nitin on setting up a subsidiary outside India at Paris for specifically carrying out the Import-Export transactions easily and soon afterwards Rahul sets up a subsidiary at Paris under the name & style of PQRS Ltd.

ABCD Ltd. is engaged in the business of manufacturing cloth for other textile companies and non-textile companies. Now the company will be itself carrying out the Import-Export

transactions without involving any 3rd Party for export purposes which it had been doing till now. It applies for the IEC – Importer Exporter Code online and gets the same. Its wholly owned subsidiary, PQRS Ltd., is engaged in the business of readymade designer garments. The subsidiary purchases garments and other stuff from its parent company. The demand for garments of PQRS Ltd. is very high and hence to cater to its shortfall, PQRS Ltd also purchases garments from other companies. Purchases are made at competitive prices. During the year 2023-24, ABCD Ltd sold garments to PQRS Ltd for Euro 13 lakhs on 1st January, 2024. The cost of these garments was ₹ 936 lakhs in the books of ABCD Ltd at the time of sale. At the year-end i.e., 31st March 2024, all these Garments were lying as closing stock with PQRS Ltd. Euro is the functional currency of PQRS Ltd. while Indian Rupee is the functional currency of ABCD Ltd.

ABCD Limited seeks help from CA Nitin on the following issues: -

(a) During the year, Rahul is finding it difficult to comprehend the GST taxation w.r.t. export sales made by their company, ABCD Ltd., which are of a peculiar nature. One such sale is where ABCD Ltd. receives an order to supply goods to a dealer 'B' in Greece. The company finds a supplier 'C' in Singapore and asks him to supply goods to 'B' in Greece. Two invoices are raised here: one by the company on 'B' in Greece and the other by 'Ç' in Singapore on ABCD Ltd. in India. The point to be noted here is that goods do not touch the Indian shores; they are shipped by 'Ç' from Singapore to 'B' in Greece. There are many more, such kind of export sales and Rahul seeks CA Nitin's help in getting out of this confusion.

(b) Rahul seeks CA Nitin's opinion on the GST procedures and treatment for the following two types of export transactions which he plans to proceed with in near future: -

- Rahul has purchased a license to put up a stall in the Textile Supermarket Global Fair to be held at Milan, Italy and he wishes to send his team to this fair along with their company's merchandise to be displayed over there for promotional purposes.
- He had heard from a dear friend that he could sell his company's products within India but these could still be categorized as exports. He was eager to know about such circumstances.

(c) The Chief accountant of the Company further seeks CA Nitin's time to understand about the valuation & taxability of the following transactions under GST:-

- ABCD Ltd. has imported a special fabric from Paris and files an ex-bond bill of entry for clearing such warehoused goods for home consumption.

- ABCD Ltd. imported textile fabric from London and sells them to a Panacea Pvt. Ltd. in India itself before the goods are cleared for home consumption. The customs declarations i.e. bill of entry etc. is filed by the agent of Panacea Pvt. Ltd. for clearance of such goods.

The Statutory audit of the company ABCD Ltd. is also being carried out by Nitin Garg & Co. under the supervision of the Engagement Partner CA Krit Garg. CA Krit understands that as the auditor, he should develop an audit plan that shall include a description of the procedures to be performed as per SA 315 & 330.The audit plan is more detailed than the overall audit strategy that includes the nature, timing and extent of audit procedures to be performed by engagement team members. Planning for these audit procedures takes place over the course of the audit as the audit plan for the engagement develops. He asks Megha in his audit team to work on planning the nature, timing and extent of specific further audit procedures and Saurab on planning of risk assessment procedures. Further, CA Krit knows that the overall audit strategy & audit plan should take into consideration the element of materiality and its relationship with Risks & procedures to be adopted CA Krit has already developed an audit strategy and while a detailed audit plan is being developed, he decides that materiality levels set earlier need to be lowered as weaknesses in the internal controls were highlighted in the internal audit reports. Subsequently, a deviation from the audit strategy is felt necessary and he is stuck in a dilemma as what to do first – modify the audit strategy and then revise the audit plan or vice-versa and seeks his Partner CA Nitin's suggestion.

I. Multiple Choice Questions

1. Which of following is responsible for issuing/granting IEC (Importer Exporter code)?

   (a) Customs under Department of Revenue, Ministry of Finance

   (b) Directorate General of Foreign trade (DGFT), Ministry of Commerce and Industry

   (c) Department for Promotion of Industry and Internal Trade (DPIIT)

   (d) Ministry of Corporate Affairs (MCA)

2. What should CA Nitin advise CA Krit to do when the latter is stuck in the revision dilemma of materiality levels set earlier?

   (a) Firstly, modify the overall strategy and thereafter, prepare the audit plan in line with the strategy.

   (b) Firstly, prepare the audit plan and then modify the overall audit strategy in line with the Plan.

(c) Modify the Audit Plan and Strategy simultaneously.

(d) Go with change in anyone, as these are not inter-related.

3. STATEMENT 1:- GST is leviable on the fabric imported from Paris while filing for its clearance.

STATEMENT 2:- GST is not leviable on the sales made to Panacea Pvt. Ltd.

(a) Statement 1 is correct but Statement 2 is incorrect.

(b) Both the Statements are Correct and independent of each other.

(c) Statement 2 is Correct & Statement 1 is incorrect.

(d) Both the Statements are incorrect

4. Considering transaction with Mr. D, one of the directors of company, which of following statements is most appropriate?

(a) The transaction with Mr. D is permissible subject to certain conditions laid down in Companies Act, 2013. However, the company is not acting in accordance with law by approaching a valuer referred to in the description. Such a valuer needs registration from The Institute of Actuaries of India to act as valuer.

(b) The transaction with Mr. D is permissible subject to certain conditions laid down in the Companies Act, 2013.The company is acting in accordance with law by approaching a valuer referred to in the description.

(c) The transaction with Mr. D is permissible subject to certain conditions laid down in the Companies Act, 2013. However, the company is not acting in accordance with law by approaching a valuer referred to in the description. Such a valuer needs registration from Insolvency and Bankruptcy Board of India to act as valuer.

(d) The transaction with Mr. D is permissible subject to certain conditions laid down in Companies Act, 2013. However, the company is not acting in accordance with law by approaching a valuer referred to in the description. Such a valuer needs registration from The Institution of Engineers (India) to act as valuer.

5. STATEMENT 1 :- In case of trade involving 'B' in Greece and 'C' in Singapore, invoicing should not have been done by ABCD Ltd. in India.

   STATEMENT 2 :- Value of such shipments has to be included by ABCD Ltd. in the value of exempt supply for the purpose of reversal of ITC under rules 42 and 43 of the CGST Rules, 2017.

   (a) Statement 1 is Correct & Statement 2 is incorrect.

   (b) Both the Statements are incorrect.

   (c) Both the Statements are correct.

   (d) Statement 1 is incorrect but Statement 2 is correct.

II. Descriptive Questions

6. Provide the accounting treatment w.r.t. transaction between ABCD Ltd. and PQRS Ltd. in their respective books of accounts. Also show its impact on consolidated financial statements. Support your answer by Journal entries, wherever necessary, in the books of ABCD Ltd.

   Following additional information is available:

Exchange rate on 1st January, 2024	1 Euro = ₹ 83
Exchange rate on 31st March, 2024	1 Euro = ₹ 85

7. As regards transaction with Mr. D, one of the directors, state few audit procedures pertaining to transaction to be performed by CA Krit Garg. Discuss probable purpose of such audit procedures also.

8. Discuss implications of proposed transaction relating to sending of company's merchandise for display in textile fair in Italy. Also discuss under what circumstances goods sold within India can still be categorized as exports under GST law and also touch upon taxability of such transactions under such law.

ANSWERS TO THE CASE STUDY 23

I. Answers to the Multiple Choice Questions

1. (b) Directorate General of Foreign trade under Ministry of Commerce and Industry is responsible for granting IEC.

2. **(a)** Firstly, modify the overall strategy and thereafter, prepare the audit plan in line with the strategy.

Reason: CA Krit should firstly modify the overall strategy and thereafter, prepare the audit plan in line with the strategy. This shows that the audit strategy and audit plan are closely inter-related as change in one is resulting into change in the other.

3. **(b)** Both the statements are Correct and independent of each other

Reason: GST is not leviable when goods deposited in customs bonded warehouse are sold before clearance; the same is leviable when ex-bond bill of entry is filed for clearing such warehoused goods for home consumption. GST is not leviable on high sea sales (the sales made to Panacea Pvt. Ltd.).

4. **(c)** The transaction with Mr. D is permissible subject to certain conditions laid down in the Companies Act, 2013. However, the company is not acting in accordance with law by approaching a valuer referred to in the description. Such a valuer needs registration from Insolvency and Bankruptcy Board of India to act as valuer.

Reason: The description provided in case study is an example of non-cash transactions with directors of company. Such transactions are governed under section 192 of Companies Act, 2013. The company can undertake such transactions after fulfillment of conditions prescribed under section 192 of Companies Act, 2013 like prior approval of such arrangement in general meeting accorded by a resolution. Further, notice of such resolution also needs to indicate value of assets involved in such an arrangement calculated by a registered valuer. Such a valuer needs qualifications and experience as described in section 247 and relevant rules and needs registration from Insolvency and Bankruptcy Board of India (IBBI) to act as valuer. The valuation examination is also conducted by IBBI.

5. **(b)** Both the Statements are Incorrect.

Reason: Third country shipments or triangular trade is a common practice in international trade whereby goods move from one country to another without touching India; only invoicing is done by the registered person in India. Paragraph 7 of the Schedule III to CGST Act provides that supply of goods from a place in the non-taxable territory to another place in the non-taxable territory without such goods entering into India (third country shipments) is treated neither as a supply of goods nor a supply of services. Thus, there is no GST liability on such sales.

Further, value of such third country shipments is not included in the value of exempt supply for the purpose of reversal of ITC under rules 42 and 43 of CGST Rules [Explanation to section 17(3) of the CGST Act].

II. Answers to the Descriptive Questions

6. Accounting treatment in the books of ABCD Ltd (Functional Currency ₹)

ABCD Ltd will recognize sales of ₹ 1079 lakhs (13 lakhs Euro x 83)

Profit on sale of Inventory = 1079 lakhs – 936 lakhs = ₹ 143 lakhs.

On balance sheet date receivable from PQRS Ltd. will be translated at closing rate i.e. 1 Euro = ₹ 85. Therefore, unrealised forex gain will be recorded in standalone profit and loss of ₹ 26 lakhs. (i.e. (85 - 83) x 13 Lakhs)

Journal Entries

	₹ (in Lakhs)	₹ (in Lakhs)
PQRS Ltd. A/c Dr.	1,079	
To Sales		1,079
(Being revenue recorded on initial recognition)		
PQRS Ltd. A/c Dr.	26	
To Foreign exchange difference (unrealised)		26
(Being foreign exchange difference recorded at year end)		

Accounting treatment in the books of PQRS Ltd. (Functional currency EURO)

PQRS Ltd will recognize inventory on 1st January, 2024 of Euro 13 lakhs which will also be its closing stock at year end.

Accounting treatment in the consolidated financial statements

Receivable and payable in respect of above-mentioned sale / purchase between ABCD Ltd and PQRS Ltd will get eliminated.

The closing stock of PQRS Ltd will be recorded at lower of cost or NRV.

	Euro (in lakhs)	Rate	₹ (in lakhs)
Cost	13	83	**1079**
NRV (Assumed Same)	13	85	1105

Therefore, no write off is required. The amount of closing stock of ₹ 1079 includes two components–

Cost of inventory for ₹ 936 lakhs; and Profit element of ₹ 143 lakhs; and

At the time of consolidation, the second element amounting to ₹ 143 lakhs will be eliminated from the closing stock.

Journal Entry

	₹ (in Lakhs)	₹ (in Lakhs)
Consolidated P&L A/c Dr.	143	143
To Inventory		
(Being profit element of intragroup transaction eliminated)		

7. The transaction with Mr. D, director of company, is in nature of non-cash transactions referred to in section 192(1) of Companies Act, 2013. Few audit procedures in this regard include: -

(i) Obtain management representation as to whether the company has undertaken any non-cash transactions with the directors or persons connected with the directors, as envisaged in section 192(1) of the Companies Act, 2013. The auditor would need to corroborate the management representation with sufficient appropriate audit evidence. Reference can be made to minute books, movements in PPE register of company, and relevant registers/records.

(ii) The auditor should check compliance with section 192(2) of the Companies Act, 2013 and verify the notice of the general meeting that it includes particulars of arrangement along with the value of the assets involved in such arrangements.

(iii) The said value of assets should be calculated by the registered valuer in compliance of Companies (Registered Valuers and Valuation) Rules, 2017.

The purpose of performing such audit procedures could be reporting requirement for non-cash transactions under clause (xv) of Paragraph 3 of CARO, 2020. The

said clause requires the auditor to report whether the company has entered into any non-cash transactions with directors or persons connected with him and if so, whether the provisions of section 192 of Companies Act have been complied with.

8. **Export of goods or services are treated as inter-State supply and zero rated.** This means that even if there is full exemption for the supply, ITC is still available to the exporter. The exporter will have an option to either pay IGST on the outward supply and claim refund of such IGST paid or export under Bond/LUT without payment of IGST and claim refund of ITC. The objective is to make Indian exports competitive in the international market. It may be noted that since exports are inter-State supplies, the tax associated with them will always be IGST.

(a) Rahul has purchased a license to put up a stall in the Textile Supermarket Global Fair to be held at Milan, Italy and he wishes to send his team to this fair along with their company's merchandise to displayed over there for promotional purposes.

= Sending/ taking goods out of India for exhibition or on consignment basis for export promotion: *Circular No. 108/27/2019 GST dated 18.07.2019* has clarified that the activity of sending/ taking goods out of India for exhibition or on consignment basis for export promotion, except when such activity satisfy the tests laid down in Schedule I of the CGST Act, does not constitute supply as the said activity does not fall within the scope of section 7 of the CGST Act , 2017as there is no consideration at that point in time. Since such activity is not a 'supply', the same cannot be **considered as "zero rated supply" as per the provisions contained in section 16 of the IGST Act, 2017.** Thus, activity of sending/ taking specified goods out of India is not a zero-rated supply. That being the case, execution of a bond or LUT, as required under section 16 of the IGST Act, is not required.

(b) He had heard from a dear friend that he could sell his company's products within India and these still can be categorized as exports..

It takes place in deemed exports. Deemed exports refers to supplies of goods manufactured in India **(and not services)** which are notified as deemed exports under section 147 of the CGST Act, 2017. Such supplies do not leave India and the payment for the same is received either in Indian rupees or in convertible foreign exchange.

Following categories of supply of goods have been notified as deemed exports by the Government vide *Notification No. 48/2017 CT dated 18.10.2017*, -

(a) Supply of goods by a registered person against Advance Authorisation (AA)

(b) Supply of capital goods by a registered person against Export Promotion Capital Goods Authorisation (EPCG)

(c) Supply of goods by a registered person to Export Oriented Unit (EOU)

(d) Supply of gold by a bank or Public sector Undertaking specified in *Notification No. 50/2017 Cus dated 30.06.2017 (*as amended) against AA

Taxability of deemed exports

Deemed exports are not zero-rated supplies by default, unlike the regular exports. Hence, all supplies notified as supply for deemed export are subject to levy of taxes, i.e. such supplies can be made on payment of tax and cannot be supplied under a Bond/LUT.

However, the refund of tax paid on the supply regarded as deemed export is admissible to either the supplier or the recipient. Thus, the application for refund has to be filed by the supplier or the recipient (subject to certain conditions) of deemed export supplies, as the case may be.

CASE STUDY 24

CA Parminder Kaur who qualified as a Chartered Accountant 3 years back has set up her own Practice in Jalandhar, Punjab. Her major expertise is in the field of consultancy to her clients regarding Global Accounting, Foreign Exchange related Legal matters, International taxation & promoting Financial Literacy. Through reference of an NRI relative, she recently bagged a contract of providing her services to the corporate house "SIMRAJ", a venture of Raj Arora & Simran Arora, husband & wife, based at Frankfurt, Germany. Raj & Simran met each other during their post-graduation days in London School of Economics and became best friends there. While Simran was simultaneously involved in the construction business of her father in London, Raj was always a kind of creative person who would like to promote innovations in the field of Healthcare and Pharmaceuticals. At present, Simran is successfully running her construction business by the name of Simran Constructions GmbH in Germany, while Raj has set up his venture by the name of Raj Pharma AG, incorporated in Germany and 63% of its shares are held by Simraj (P) Ltd., an Indian company. Raj Pharma AG has its presence in India also.

Simran's one of the biggest construction project was being executed in India at Amritsar through Sim Contractors Pvt. Ltd., another company based in India, shortly known as "SIMCO", which is a foreign operation of Simran Constructions GmbH, primarily set up to execute construction projects in India. The functional currency of Simran Constructions GmbH is Euros. 78% of SIMCO's finances have been raised in USD by way of contribution from Simran Constructions GmbH. SIMCO's bank accounts are maintained in USD as well as in INR. Cash flows generated by it are transferred to the German Company on a monthly basis in USD in respect of repayment of finance received from the German Company. Revenues of SIMCO are in USD. Its competitors are globally based. Tendering for the construction project happened in USD. SIMCO incurs 80% of the cost in INR and remaining 20% costs in USD.

While carrying out this construction project in Amritsar, SIMCO was in need of a heavy excavation machinery "XALTI" which was not available in India. CA Parminder arranges a meeting of SIMCO's Manager in India with one of her clients, Mr. Amit Juneja, at the request of Simran to enter into a contract of importing this machinery from out of India. Mr. Juneja has been in the business of trading in heavy machineries used in construction business since the past 5 years and had been planning since long to start importing highly technical machines from outside India to include in his trade segment. He felt it to be the right time and opportunity to enter into the Global market. He imported "XALTI" from Malta Machineries based in France. CA Parminder guides and helps Mr. Juneja to execute this import transaction following all the general guidelines as laid under the domestic laws of India. Along with this transaction, Mr. Juneja requires to transfer U.S. $ 15,000 for remittance towards hiring charges of transponders

to be paid to Ross and U.S. $ 20,000 to be paid to Chandler for payment related to call back services of telephones, both being foreign nationals.

Raj Arora is very curious to know about the compliances to be made by Raj Pharma AG. He provides the following details to CA Parminder Kaur relating to Raj Pharma AG for the P.Y. 2023-24:

Particulars		India	Germany
Fixed assets at depreciated values for tax purposes (₹ in crores)		100	60
Intangible assets (₹ in crores)		50	100
Other assets (value as per books of account) (₹ in crores)		40	120
Income from trading operations (₹ in crores)		50	75
The above figure includes:			
(i)	Income from transactions, where purchases are from associated enterprises and sales are to unrelated parties	2	4
(ii)	Income from transactions, where sales are to associated enterprises and purchases are from unrelated parties	3	5
(iii)	Income from transactions, where both purchases and sales are from/to associated enterprises	5	10
Interest and dividend from investments (₹ in crores)		30	20
Number of employees (Residents in respective countries)		60	90
Payroll expenses on employees (₹ in crores)		10	15

During F.Y.2023-24, eight board meetings of Raj Pharma AG were held – 3 in India and 5 in Germany.

Raj Pharma AG's Indian counterpart – Simraj (P) Ltd. required a high tech machinery "Medifix" to be purchased from Cambridge, UK. For importing such machinery, Raj contacted one of his friends in Cambridge, who runs a company by the name of "Medico Inc.", a London based company, having several business units all over the world. It has a unit for manufacturing pharma machineries with its Headquarters in New Delhi. It has a branch in Dubai which is controlled by the Headquarters in New Delhi. However, "Medifix", being not available with 'Medico Inc.', Raj's friend in Cambridge helped him to procure the machinery from another company in Frankfurt, Germany known to him. This foreign currency asset amounting to Euro 100,000 is recorded by Simraj (P) Ltd. as a non-monetary item at the date of purchase when the exchange rate was ₹ 52 at ₹ 52 lakhs. The recoverable amount of the asset on the reporting date is calculated as Euro 90,000. The exchange rate on the date of valuation was ₹ 60 to a Euro and the carrying amount of Medifix recorded accordingly, as per the relevant Ind-AS, in the books of Simraj (P) Ltd. is ₹ 54 lakhs.

Raj and Simran, both made several trips to India during the previous year and they are quite skeptical about the taxation of their income in both the countries – Germany & India. One day, over dinner table, they discussed all these aspects. Raj, having an experience in International tax matters and having discussed the same with CA Parminder tells Simran that in the case of income arising to an assessee in countries with which India does not have any double taxation agreement, relief would be granted under the Indian Income tax law subject to fulfilment of certain conditions. Simran tells him that one of her friends told her in a Kitty party that the double taxation avoidance treaties entered into by the Government of India with other countries can never ever override the domestic law of India.

Further, Simran is curious to tell Raj about her father's business in the same segment and how her father is doing so good with the finances of the business that inspires her as well. She tells Raj that one of her father's business set-ups in India by the name of Entity "P" whose functional currency is '₹', has a foreign operation, Entity "Q" with Euro as its functional currency. Entity Q issued to Entity P, a perpetual debt denominated in Euros with an annual interest rate of 6%. The perpetual debt has no issuer call option or holder put option. Thus, contractually it is just an infinite stream of interest payments in Euros.

Further, being highly impressed with CA Parminder's work and quality of her performance, they both decided to offer her the role of CFO in their German Group "SIMRAJ" and wanted her to get migrated to Germany to which CA Parminder agreed. As per the offer letter, Parminder should join the company at any time between 1st September, 2023 and 31st October, 2023. She has maintained a joint account with her father in UCO Bank, Jalandhar, in India.

I. Multiple Choice Questions

1. Referring to the provisions of the Foreign Exchange Management Act, 1999, state the kind of approval required for the transactions to be carried out by Mr. Amit Juneja for payment to Ross and Chandler respectively:-

   (a) Ross :- Central Government ; Chandler :- Reserve Bank of India

   (b) Ross :- Reserve Bank of India; Chandler :- Central Government

   (c) Ross :- Prohibited Transaction ; Chandler :- Reserve Bank of India

   (d) Ross :- Central Government ; Chandler :- Prohibited Transaction

2. What would be the residential status under the FEMA, 1999, of Pharma unit of "Medico Inc." in New Delhi and that of Dubai branch?

   (a) Both are persons resident outside India.

   (b) New Delhi Headquarters – Resident person & Dubai Branch – Non-resident person

   (c) Both are persons resident in India.

(d) New Delhi Headquarters – Non-resident person & Dubai Branch – Resident-person

3. Determine the value of Impairment loss in foreign currency with respect to "Medifix" and whether it should be recognised in books by Simraj (P) Ltd.?

(a) Euro 10,000 should be recognised as impairment loss

(b) ₹ 2 lakh should be recognized as impairment loss

(c) ₹ 2 lakh should not be recognised as impairment loss

(d) Euro 10,000 should not be recognised as impairment loss

4.. In Entity P's consolidated financial statements, can the perpetual debt be considered, in accordance with Indian Accounting Standards, a monetary item "for which settlement is neither planned nor likely to occur in the foreseeable future" (i.e. part of P's net investment in Q), with the exchange gains and losses on the perpetual debt therefore being recorded in equity? Entity "P's" functional currency is INR, and Entity "Q's" functional currency is Euro.

(a) Yes, the Perpetual Debt can be considered as a monetary item and the related exchange gains and losses should not be recognised.

(b) No, the Perpetual Debt should not be considered as a monetary item and the related exchange gains and losses should not be recognised accordingly.

(c) Yes, the Perpetual Debt can be considered as a monetary item and the related exchange gains and losses should be recorded in equity at the consolidated level.

(d) No, the Perpetual Debt should not be considered as a monetary item and the related exchange gains and losses should be recognised in consolidation of accounts.

5. By what date maximum, should CA Parminder leave India and how should she receive her salary to minimize her tax liabilities in India, if her total income during P.Y. 2023-24 was ₹ 14 lakhs?

(a) She should leave India on or before 28 September, 2023 and get her salary credited to a Bank account in Germany only, to be remitted, later on, to her Joint account in India.

(b) She should leave India on or before 27 September, 2023 and get her salary credited directly to her Joint account in India.

(c) She should leave India on or before 27 September, 2023 and get her salary credited to a Bank account in Germany only, to be remitted, later on, to her Joint account in India

(d) She should leave India on or before 28 September, 2023 and get her salary credited directly to her Joint account in India.

II. Descriptive Questions

6. Mr. Amit Juneja wants to know from CA Parminder, the various modes of payment he can use, to make payment to Malta Machineries for importing "XALTI". Also, he requests her to guide on the time-limit for making settlement of such payment as laid under the Domestic law.

7. Can INR be presumed as the Functional Currency for SIMCO?

8. Determine the residential status of Raj Pharma AG for A.Y.2024-25, as per the Indian Income tax law.

ANSWERS TO THE CASE STUDY 24

I. Answers to the Multiple Choice Questions

1. **(d)** Ross: Central Government: Chandler: Prohibited Transaction

Reason: Under section 5 of the Foreign Exchange Management Act, 1999, and Rules relating thereto, some current account transactions require prior approval of the Central Government, some others require the prior approval of the Reserve Bank of India, some are freely permitted transactions and some others are prohibited transactions. Accordingly,

(i) It is a current account transaction, where Amit is required to take approval of the Central Government for drawal of foreign exchange for remittance of hire charges of transponders.

(ii) Withdrawal of foreign exchange for payment related to call back services of telephone is a prohibited transaction. Hence, Amit cannot obtain US $ 20,000 for the said purpose.

2. **(c)** Both are persons resident in India.

Reason: Medico Inc. being a UK based company would be person resident outside India [(Section 2(w)]. Section 2 (u) defines 'person' under clause (viii) thereof, as person would include any agency, office or branch owned or controlled by such person. The term such person appears to refer to a person who is included in clause (i) to (vi). Accordingly, the Headquarters in New Delhi, being a branch of a company would be a 'person'. Section 2(v) defines a person resident in India. Under clause (iii) thereof person resident in India would include an office, branch or agency in India owned or controlled by a person resident outside India.

Headquarters Unit in New Delhi is owned or controlled by a person resident outside India, and hence it, would be a 'person resident in India.' However, Dubai Branch though not owned is controlled by the Headquarters in New Delhi which is a person resident in India. Hence, the Dubai Branch is also a person resident in India.

3. (d) Euro 10,000 should not be recognized as impairment loss

Reason: The carrying value of the foreign currency asset will be determined based on the recoverable amount of the asset converted into functional currency at the exchange rate on valuation date which is ₹ 54 lakhs. Therefore, the impairment loss of Euro 10,000 in foreign currency should not to be recognised.

4. (c) Yes, the Perpetual Debt can be considered as a monetary item and the related exchange gains and losses should be recorded in equity at the consolidated level.

Reason: Yes, as per Ind AS 21, net investment in a foreign operation is the amount of the reporting entity's interest in the net assets of that operation. As per para 15 of Ind AS 21, an entity may have a monetary item that is receivable from or payable to a foreign operation. An item for which settlement is neither planned nor likely to occur in the foreseeable future is, in substance, a part of the entity's net investment in that foreign operation. Such monetary items may include long-term receivables or loans. They do not include trade receivables or trade payables. In accordance with para 15 of Ind AS 21, the foreign exchange gains and losses should be recorded in equity at the consolidated level because settlement of that perpetual debt is neither planned nor likely to occur.

5. (a) She should leave India on or before 28th September, 2023 and get her salary credited to a Bank account in Germany only, to be remitted, later on, to her Joint account in India

Reason: In this case, since Parminder is an Indian citizen and leaving India during P.Y. 2023-24 for the purpose of employment outside India, she will be treated as resident only if the period of her stay during the previous year amounts to 182 days or more. Therefore, Parminder should leave India on or before 28th September, 2023, in which case, her stay in India during the previous year would be less than 182 days and she would become non-resident for the purpose of taxability in India. In such a case, only the income which accrues or arises in India or which is deemed to accrue or arise in India or received or deemed to be received in India shall be taxable. The income earned by her in Germany would not be chargeable to tax in India for A.Y. 2024-25, if she leaves India on or before 28th September, 2023. If any part of Parminder's salary will be credited directly to her bank account in Jalandhar, then, that part of her salary would be considered as income received in India during the previous year under section 5 and would

be chargeable to tax under Income-tax Act, 1961, even if she is a non-resident. Therefore, Parminder should receive her entire salary in Germany and then remit the required amount to her bank account in Jalandhar in which case, the salary earned by her in Germany would not be subject to tax in India.

II. Answers to the Descriptive Questions

6. As per Master Direction No. 17 on Import of Goods and Services issued by the RBI, the general Guidelines for Imports are as follows:-

(i) **Mode of payment**: A person resident in India may make payment for import of goods in foreign exchange through-

- an international card held by him/in rupees from international credit card/ debit card through the credit/debit card servicing bank in India against the charge slip signed by the importer, or
- as prescribed by Reserve Bank from time to time,

provided that the transaction is in conformity with the extant provisions and the import is in conformity with the Foreign Trade Policy in force. In essence, payment has to be made through banking channels.

Any person resident in India may also make payment as under:

(a) In rupees towards meeting expenses on account of boarding, lodging and services related thereto or travel to and from and within India of a person resident outside India who is on a visit to India;

(b) By means of a crossed cheque or a draft as consideration for purchase of gold or silver in any form imported by such person in accordance with the terms and conditions imposed under any order issued by the Central Government under the Foreign Trade (Development and Regulations) Act, 1992 or under any other law, rules or regulations for the time being in force;

(c) A company or resident in India may make payment in rupees to its non-whole time director who is resident outside India and is on a visit to India for the company's work and is entitled to payment of sitting fees or commission or remuneration, and travel expenses to and from and within India, in accordance with the provisions contained in the company's Memorandum of Association or Articles of Association or in any agreement entered into it or in any resolution passed by the company in general meeting or by its Board of Directors, provided the requirement of any law, rules, regulations, directions applicable for making such payments are duly complied with.

(ii) Time Limit for Settlement of Import Payments:

(i) Time limit for Normal Imports:

- In terms of the extant regulations, remittances against imports should be completed not later than six months from the date of shipment, except in cases where amounts are withheld towards guarantee of performance, etc.
- AD may permit settlement of import dues delayed due to disputes, financial difficulties, etc. However, interest if any, on such delayed payments, usance bills (a bill of exchange which allows the drawee to have period of credit or term) or overdue interest is payable only for a period of up to three years from the date of shipment at the rate prescribed for trade credit from time to time.

(ii) Time Limit for Deferred Payment Arrangements:

- Any deferred payment arrangements (including suppliers' and buyers' credit) entered into, for up to three years in case of import of capital goods and up to one year or the operating cycle whichever is less, in case of import of non-capital goods, shall be treated as trade credits for which the procedural guidelines as laid down in the Master Direction on External Commercial Borrowings, Trade Credits and Structured Obligations (updated from time to time) may be followed.

(iii) Extension of Time:

(i) limit of extension: AD Category – I banks can consider granting extension of time for settlement of import dues up to a period of six months at a time (maximum up to the period of three years) irrespective of the invoice value for delays on account of disputes about quantity or quality or non-fulfilment of terms of contract; financial difficulties and cases where importer has filed suit against the seller. In cases where sector specific guidelines have been issued by Reserve Bank of India for extension of time (i.e. rough, cut and polished diamonds), the same will be applicable.

(ii) Circumstances: While granting extension of time, AD must ensure that:

a. The import transactions covered by the invoices are not under investigation by Directorate of Enforcement / Central Bureau of Investigation or other investigating agencies;

b. While considering extension beyond one year from the date of remittance, the total outstanding of the importer does not exceed

USD one million or 10 per cent of the average import remittances during the preceding two financial years, whichever is lower; and

c. Where extension of time has been granted by the AD, the date up to which extension has been granted may be indicated in the 'Remarks' column.

(iii) Cases not covered by the above instructions / beyond the above limits, may be referred to the concerned Regional Office of Reserve Bank of India.

(iv) The above shall be reported in IDPMS as per message "Bill of Entry Extension" and the date up to which extension is granted will be indicated in "Extension Date" column.

7. No, SIMCO cannot presume INR to be its functional currency on the basis of its location. It needs to consider various factors listed in Ind AS 21 for determination of functional currency.

Primary indicators:

1. The currency that mainly influences:

   (a) sales prices for its goods and services. This will often be the currency in which sales prices are denominated and settled; and of the country whose competitive forces and regulations mainly determine the sales prices of its goods and services.

   (b) labour, material and other costs of providing goods and services. This will often be the currency in which these costs are denominated and settled.

2. Other factors that may provide supporting evidence to determine an entity's functional currency are ***(Secondary indicators):***

   (a) the currency in which funds from financing activities (i.e. issuing debt and equity instruments) are generated; and

   (b) the currency in which receipts from operating activities are usually retained.

3. ***If an entity is a foreign operation***, additional factors set out in Ind AS 21 should be considered to determine whether its functional currency is the same as that of the reporting entity of which it is a subsidiary, branch, associate or joint venture:

   a. Whether the activities of foreign operations are carried out as an extension of that reporting entity, rather than being carried out with a significant degree of autonomy;

   b. Whether the transactions with the reporting entity are a high or a low proportion of the foreign operation's activities;

c. Whether cash flows from the activities of the foreign operations directly affect the cash flows of the reporting entity and are readily available for remittance to it.

d. Whether cash flows from the activities of the foreign operation are sufficient to service existing and normally expected debt obligation without funds being made available by the reporting entity.

On the basis of additional factors mentioned in point 3 above, SIMCO cannot be said to have functional currency same as that of Simran Constructions GmbH.

Hence, primary and secondary indicators should be used for the determination of its functional currency giving priority to primary indicators. The analysis is given below:

- Its significant revenues and competitive forces are in USD.
- Its significant portion of cost is incurred in INR. Only 20% costs are in USD.
- 78% of its finances have been raised in USD.
- It retains its operating cash flows partially in USD and partially in INR.

Keeping these factors in view, USD should be considered as the functional currency of Sim Contractors Pvt. Ltd.

8. **The residential status of a foreign company is determined on the basis of place of effective management (POEM) of the company.** For determining the POEM of a foreign company, the important criteria is whether the company is engaged in active business outside India or not.

A company shall be said to be engaged in "Active Business Outside India" (ABOI) for POEM, if

- the passive income is not more than 50% of its total income; and
- less than 50% of its total assets are situated in India; and
- less than 50% of total number of employees are situated in India or are resident in India; and
- the payroll expenses incurred on such employees is less than 50% of its total payroll expenditure.

Raj Pharma AG shall be regarded as a company engaged in active business outside India for P.Y. 2023-24 for POEM purpose only if it satisfies all the four conditions cumulatively:-

Condition 1: The passive income of Raj Pharma AG should not be more than 50% of its total income

Total income of Raj Pharma AG during the P.Y. 2023-24 is ₹ 175 crores [(₹ 50 crores + ₹ 75 crores) + (₹ 30 crores + ₹ 20 crores)]

Passive income is the aggregate of, -

(i) income from the transactions where both the purchase and sale of goods is from/to its associated enterprises; and

(ii) income by way of royalty, dividend, capital gains, interest or rental income;

Passive Income of Raj Pharma AG is ₹ 65 crores, being sum total of:

(i) ₹ 15 crores, income from transactions where both purchases and sales are from/to associated enterprises (₹ 5 crores in India and ₹ 10 crores in Germany)

(ii) ₹ 50 crores, being interest and dividend from investment (₹ 30 crores in India and ₹ 20 crores in Germany)

Percentage of passive income to total income = ₹ 65 crore/ ₹ 175 crore x 100 = 37.14%

Since passive income of Raj Pharma AG is 37.14%, which is not more than 50% of its total income, the first condition is satisfied.

Condition 2: Raj Pharma AG should have less than 50% of its total assets situated in India

- Value of total assets of Raj Pharma AG during the P.Y. 2023-24 is ₹ 470 crores [₹ 190 crores, in India + ₹ 280 crores, in Germany]
- Value of total assets of Raj Pharma AG in India during the P.Y. 2023-24 is ₹ 190 crores
- Percentage of assets situated in India to total assets = ₹ 190 crores/₹ 470 crores x 100 = 40.43%.

Since the value of assets of Raj Pharma AG situated in India is less than 50% of its total assets, the second condition for ABOI test is satisfied.

Condition 3: Less than 50% of the total number of employees of Raj Pharma AG should be situated in India or should be resident in India

- Number of employees situated in India or are resident in India is 60 Total Number of employees of Raj Pharma AG is 150 [60 + 90]
- Percentage of employees situated in India or are resident in India to total number of employees is 60/150 x 100 = 40%

Since employees situated in India or are residents in India of Raj Pharma AG are less than 50% of its total employees, the third condition for ABOI test is satisfied.

Condition 4: The payroll expenses incurred on employees situated in India or resident in India should be less than 50% of its total payroll expenditure

- Payroll expenses on employees employed in and resident of India = ₹ 10 crores.
- Total payroll expenses = ₹ 25 crores (₹ 10 crores + ₹ 15 crores)
- Percentage of payroll expenses of employees situated in India or are resident in India to the total payroll expenses = 10 x 100/25 = 40%

Since the payroll expenses incurred on employees situated in India or resident in India is less than 50% of its total payroll expenditure, the fourth condition for ABOI test is also satisfied.

Thus, since Raj Pharma AG has satisfied all the four conditions, the company would be said to be engaged in "active business outside India" during the P.Y. 2023-24.

POEM of a company engaged in active business outside India shall be presumed to be outside India, if the majority of the board meetings are held outside India.

Since Raj Pharma AG is engaged in active business outside India in the P.Y. 2023-24 *and majority of its board meetings i.e., 5 out of 8, were held outside India, POEM of Raj Pharma AG would be outside India.*

Therefore, Raj Pharma AG would be non-resident in India for the P.Y. 2023-24.

CASE STUDY 25

Fresh Foods is a popular fast food joint in Bangalore. It was formed by the partnership of 3 friends Ajay, Biren and Chand. Ajay and Biren are working partners, while Chand is a non-working partner. For the previous year 2023-24, Fresh Foods reported a net profit of ₹ 30,00,000 before the following deductions:

(1) Salary of ₹ 50,000 each per month payable to Ajay and Biren. Salary of ₹ 10,000 per month payable to Chand. These payments have been authorized by the partnership deed.

(2) Depreciation on plant and machinery under section 32 (computed) ₹ 5,00,000.

(3) Interest on capital at 15% per annum on the capital of Ajay, Biren and Chand. The capital on which interest is to be calculated is Ajay: ₹ 10,00,000; Biren: ₹ 10,00,000 and Chand: ₹ 50,00,000.

A general survey published in a food trade magazine highlighted people's perception about the food served by food joints across the city. Current food platter was found to be predominantly unhealthy. People want healthier choices in the menu when they dine out. At the same time, they do not want to compromise on taste or presentation of the food item.

The partners have decided to use this as an opportunity to entirely revamp Fresh Foods as a speciality restaurant that offers healthier variety of food choices catering to the health-conscious customers. Ajay, Biren and Chand are having a meeting to discuss this venture in further detail.

The partners would restate their mission as: ***"Spread health and happiness through the craft of cooking, catering to the discerning palette that forge long lasting bonds with our loyal customers."***

"A menu focussed on vegan and vegetarian food options emphasizing the natural, organic and high quality of ingredients would give us a niche segment of loyal customers." - Chand

"How would we be able to assess the market size? The food industry is largely unorganized and within that there is no data available for ventures like ours that catering to health-conscious customers." - Ajay

"You are correct! There is no easy way to measure the market size. So let us set to conquer this unchartered territory. At this nascent stage, let us first begin serving this menu at our restaurant only for lunch and dinner. Our restaurant has a capacity to seat 50 customers at a time. Our restaurant should be filled at least 90%, if not more during the peak hours when it is open. If we are overbooked regularly, we can even consider expanding our operations."- Chand

"Catering to the health-conscious customer is not a novel idea. Many have tried it out before and failed. Investment in kitchen infrastructure, redoing ambience and décor to match the product offering would costs us at least ₹ 5 crores as initial investment. We would need to raise a term loan from the bank for this. We need to generate sufficient profits to repay the loan. Due to overall uncertain business conditions after the pandemic, the bank may in turn expect us to maintain certain levels of debt service ratio or interest coverage ratio. In addition, our benchmark has been to earn at least 18% ROI. Since our menu offerings are going to be unique and healthy, we have some leverage to charge higher price to our customers. At the same time, industry margins are under pressure due to inflationary conditions as our input costs of material, labour and overheads are continuously rising. How do we achieve financial stability?" - Biren

"Yes, we are in this business to make money! So let us reengineer our menu. Let us segregate items based on their popularity and profitability. Class A items will be highly popular and profitable. Class B items on the list would be highly popular but not that profitable. Class C items on the menu would be profitable but not very popular. Class D items are the ones over time show that they are neither popular nor profitable! This segregation will give us ample information on which items should be our focus areas while knowing how much margins they would generate! I expect to generate turnover of about ₹ 60 lakh in the first year of operations, with an increase of at least 3% each year. While this gives us a first mover advantage, we need to constantly re-engineer our menu to beat our competitors who may also start replicating our model and menu. For this, let us take constant feedback from our customers."

- Chand

"This would be possible only if we have expert chefs and a team that can handle speciality dishes, catering to different customer preferences, in a cost-effective manner. Popularity is also driven by the quality of food that we serve. High quality standards drive growth. Periodic weekly quality checks would be required. External certifications from government food inspectors and other recognized agencies would also be required to be met. We need to keep a formal record of quality issues identified by either the customer or team." - Ajay

"Yes, quality has to be matched with service. Ours is a customer centric business. Hence, personnel interacting with the customers should have good people management skills. Complaints should be handled in a professional yet personable manner, for which our customer facing staff have to be trained. Service also means that orders given by the customer should be delivered correctly as per their expectations. Errors in order taking process, stock outs due to unavailability of material should be avoided at all costs. It should be our aim to deliver the food within 15 minutes after placing the order and the food should be both warm and fresh. Rejected raw material, customer rejections of food delivered also need to be tracked. Again, our formal record also needs to capture these errors, inability to deliver orders, delays in delivery of food." - Biren

"COVID pandemic taught us an important lesson on maintain a robust supply chain that can deal with disruptions. For critical resources such as raw material, labour etc. our firm should have multiple partners who can provide for the requirements reliably. This will also be helpful when we scale up operations in future." - Chand

"Not just that, our internal processes should make efficient use of resources. The order taking system and food delivery system should work in sync and support each other to avoid errors and stock outs. Our core team of chefs should be adept at minimizing waste and preparing unique dishes in an economical way! We need build a kitchen infrastructure that can support this providing them with appropriate space, machines and tools for cooking and storage. As regards our marketing process, we may need to use technological solutions like social media platforms to reach out to potential customers." - Ajay

"High staff attrition is a perennial problem in our industry. Expert chefs are our key to success. Should we explore the possibility of taking out Keyman Insurance policy on key employees, including us partners. This would not only boost their morale but also help in retaining them. The Speciality chefs may also enjoy working with us if we give them sufficient scope for innovation to satisfy customers, cost permitting of course!" - Biren

"Wonderful! I am excited at the range of possibilities this venture can offer. Let us get started by putting in place a system for performance measurement of various parameters." - Chand

It was decided that Ajay would be in charge of restaurant operations (supply chain management activities like material / labour procurement, kitchen operations, supply chai and quality control and any other daily business operations), Biren would be in charge of finance, administration and marketing. He vegetarian will be in charge of activities like negotiating settlement dates with vendors, procuring loans at effective rates, promotional campaigns to build the firm's visibility. Chand would continue to be a non-working partner giving strategic insights and if needed additional capital infusion for any business needs. There will be separate departments created to form a proper organization structure with clearly defined authority and responsibility. The periodic management of the menu which will define the food choices based on their profitability and popularity among customers will be decided jointly by all three partners. The partnership deed is being modified accordingly to reflect the new roles and responsibilities.

Based on above case study, answer the following questions: -

I. Multiple Choice Questions

1. Which of the following is true regarding Keyman Insurance Policy?

   (i) Any sum received under Keyman Insurance Policy is taxable in the hands of Fresh Foods.

(ii) Insurance paid under Keyman Insurance Policy pertaining to life of partners of Fresh Foods is a deductible expenditure

(iii) Bonus received under Keyman Insurance Policy is taxable in the hands of Fresh Foods

Options

(a) (i) and (iii)

(b) (i) and (ii)

(c) (i), (ii) and (iii)

(d) Only (ii)

2. Fresh Foods has approached Indi Bank Ltd. for a term loan of ₹ 5 crores. For this they need to submit prospective financial statements. Fresh Foods has approached CA Anil for examination of the prospective financial statements that it has prepared. Which of the following statements is not true regarding examination of prospective financial statements by CA Anil?

(i) CA Anil need not be the statutory auditor of Fresh Foods to accept the engagement to examine the prospective financial statements.

(ii) CA Anil can express an opinion on whether the results shown in the prospective financial information can be achieved or not.

(iii) CA Anil can vouch for the accuracy of projections while examining the prospective financial statements.

(iv) CA Anil should consider the sources of information considered by the partners for the purpose of preparing prospective financial statements, their adequacy, reliability of underlying data including data derived from third parties such as industry statistics, to support the assumptions.

Options

(a) (i) and (iii)

(b) (ii) and (iiii)

(c) (iii) and (iv)

(d) (i) and (iv)

3. Which of the following statements would not be true as regards product pricing for the individual food items?

(a) Standard costing techniques may be used to compute the costs of individual food items.

(b) Target costing techniques may be used for managing profitability of food items having popular close substitutes (even if they are not as healthy) that are offered by competitors.

(c) Product pricing to be used to determine expected revenue for yearly budgetary planning which can be determined based on relevant costing techniques.

(d) If the price quality perception or the unique value perception for certain food items is high, customers will be less price sensitive for those items.

4. Which of the following will not be value added activity?

(i) Inspection of food items on a regular weekly basis to ensure quality standards are met

(ii) Using Kaizen costing methodologies to reduce the turnaround time in delivering the order to the customer.

(iii) Redoing the food items as they did not match the customer specifications that were given while placing the order.

(iv) Wait time of batch of food item for baking process as the ovens in the kitchen are occupied in baking other batches of food items.

Options

(a) (i), (iii) and (iv)

(b) (ii), (iii) and (iv)

(c) (i), (ii) and (iii)

(d) (ii), (iii) and (iv)

5. The partners have identified certain critical success factors (CSFs) for Fresh Foods like tracking menu offerings that maximize customer satisfaction, customer service related parameters like complaints, customer response time etc. Which of the following is true about CSFs?

(a) These factors contribute towards reducing costs

(b) These factors are fundamental to strategic success

(c) These factors need to be only financial factors

(d) These factors concentrate on achieving short term goals

II. Descriptive Questions

6. (i) Calculate the book profit of the partnership for the purpose of calculation of allowable deduction for salary paid to partners as per the Income Tax Act, 1961

(ii) Allowable deduction for salary paid to partners the assessment year 2024-25.

7. Fresh Foods is in the service industry, where it is essential to link strategy to the management of human resources. The partners would like to have a framework based on the Building Block model to assess performance management. Using performance management system as proposed by the model EVALUATE the following questions:

(I) What dimensions of performance should Fresh Food measure? Dimensions are the goals that the firm wants to achieve based on its overall strategy, those goals that define its success.

(II) How to set the standards (benchmarks) for the dimensions determined for Fresh Foods?

(III) What are the characteristics of rewards system needed to motivate employees to achieve the standards determined for Fresh Foods?

ANSWERS TO THE CASE STUDY 25

I. Answers to the Multiple Choice Questions

1. **(c)** (i), (ii) and (iii)

Reason: Any sum including bonus received under Keyman Insurance Policy is taxable in the hands of Fresh Foods and insurance paid under Keyman Insurance Policy pertaining to life of partners of Fresh Foods is a deductible expenditure.

2. **(b)** (ii) and (iiii)

Reason: Statements (ii) and (iii) are not true regarding examination of prospective financial statements by CA Anil.

CA Anil cannot express an opinion on whether the results shown in the prospective financial information can be achieved or not. CA Anil cannot vouch for the accuracy of projections while examining the prospective financial statements.

3. **(c)** Product pricing to be used to determine expected revenue for yearly budgetary planning which can be determined based on relevant costing techniques.

Reason: Relevant costing is used for short-run tactical decision making, where one course of action has to be taken amongst various feasible options. These are business decisions are made concerning very specific business situations

which exist over a very short time horizon. Yearly budgeting planning has a longer time frame and requires strategic decision making rather than tactical decision making. Hence, relevant costing techniques may not be very useful here. Standard costing techniques may be used to determine the standard rate of material, labor, overheads etc. while determining the price of individual products.

4. (a) (i), (iii) and (iv)

Reason: Inspection utilizes time and resources to ensure that products meet specifications. While it is essential, it does not add additional value to the product itself and has to be minimize by following quality management techniques. Rework on the order due to not meeting customer specifications is a waste of time and resources and does not add value to the product. Wait time lost due to non availability of ovens arises due to bottlenecks in the process and hence is a waste, non value adding activity.

Kaizen costing methodologies aim to eliminate waste in business processes. Reduction in the turnaround time in delivering the order to the customer ensures shorter customer response time, builds efficiency and add value for customer. Hence, this is value adding activity.

5. (b) These factors are fundamental to strategic success

Reason: These factors are fundamental to strategic success. CSF provide information that can be used to outperform competitors and improve on its core competencies.

II. Answers to the Descriptive Questions

6. (i) As per *Explanation 3* to section 40(b), "book profit" shall mean the net profit as per the profit and loss account of the previous year computed as laid down in Chapter IV-D as increased by the aggregate amount of the remuneration paid or payable to the partners of the firm if the same has been already deducted while computing the net profit.

In the present case, the net profit given is before deduction of depreciation on plant and machinery, interest on capital of partners and salary to the working partners. Therefore, the book profit will be computed as follows:

Particulars	**₹**	**₹**
Net Profit (before deduction of depreciation, interest and salary)		30,00,000
Less:		

Depreciation on plant and machinery as per section 32	5,00,000	
Interest @ 12% p.a. (maximum allowable as per section 40(b))		
Ajay – 12% of ₹ 10,00,000 = 1,20,000		
Biren – 12% of ₹ 10,00,000 = 1,20,000		
Chan – 12% of ₹ 50,00,000 = 6,00,000		
Total interest deductible	8,40,000	
Total deductions		13,40,000
Book Profit		16,60,000

(ii) As per section 40(b), remuneration paid to non-working partner whether in the form of salary, bonus, commission or whatever name called is not allowed to be deducted in computing business income. Hence, remuneration of ₹ 10,000 per month i.e. ₹ 1,20,000 per annum paid to non-working partner Chand is not allowed as a deduction.

Ajay and Biren, the working partners were each paid ₹ 50,000 per month. Hence, the working partners totally received ₹ 12,00,000 per annum as salary.

As per section 40(b)(v) the salary paid to working partners will be allowed subject to the following limits:

On the first ₹ 3,00,000 of book profit or in case of loss	₹1,50,000 or 90% of book profit, whichever is more
On the balance of book profit	60% of the balance book profit

Therefore, the maximum allowable working partner's salary for the A.Y. 2024-25 would be:

Particulars	**₹**
On the first ₹ 3,00,000 of book profit (₹ 1,50,000 or 90% of book profit, whichever is more)	2,70,000
On the balance book profit	8,16,000
(60% of (₹ 16,60,000 - ₹ 3,00,000)	
= 60% of ₹ 13,60,000	
Total	10,86,000

Hence, the allowable partner salary for the A.Y. 2024-25 as per the provisions of section 40(b) would be ₹ 10,86,000 as against an actual payout of ₹ 12,00,000 to Ajay and Ben and ₹ 1,20,000 to Chand.

7. (I) **Dimensions at Fresh Foods:** Dimensions (goals) include financial and non-financial goals. Dimensions are further categorized as into results and determinants. Results are tracked as (a) financial performance and (b) competitive performance. Determinants are tracked as (a) quality, (b) flexibility (c) innovation and (d) resource utilization. Determinants influence results.

Results:

(a) Financial performance (result): Fresh Foods is a closely held partnership with 3 partners. Partners are interested in earning profits that have been benchmarked at an overall return on investment of at least 18% each year. Partners want to retain the current capital structure. They may take loans from banks for funding their expansion. They expect certain conditions to be laid down in terms of the debt service ratio and interest service ratio that may need to be maintained for the period that the loan is outstanding.

Profits margins under the industry are under pressure due to inflationary trends. Hence, despite having the leverage of charging premium prices to customers due the nature of the menu offered, Fresh Food has to track the profitability of business very closely.

Profits will be derived from the periodic financial statements that get prepared as part of the accounting function. In addition, other financial performance dimensions like profitability ratios like gross profit ratio, net profit ratio, operating margin, return of capital employed, cash profit and changes in cash reserves will provide information about the business profitability.

(b) Competitive performance (result): Fresh Foods wants to be a niche joint in a highly competitive segment. Their basis for competition is providing healthier food choices to customers based on vegetarian and vegan diet. However, comparison of peer performance is restricted on account of limitation in terms of availability of information due to the unorganized nature of the food industry. All the same, to begin with, one of the measures that can be helpful, will be the utilization of their 50 seat capacity at their restaurant. The benchmark capacity utilization of at least 90% would indicate that there is sufficient demand for their product offerings. In due course, based on popularity and profitability of the venture, it can consider further expansion plans. Segregation of its

offerings into various classes such as A, B, C and D would help the management identify a good mix of popular and profitable items. This will help it develop its competitive edge.

Since the restaurant is a proposed trend setter within the industry, it will retain a competitive edge until its peers start replicating the same. Therefore, as this segment develops within the industry, one other measure for competitive performance could be re-engineer the menu to maintain variety and uniqueness as compared to its peers. Information to develop a robust menu offering could be gathered from published / researched sources like trade magazines as well as informal sources like customer feedback / word of mouth.

Determinants:

(c) Quality (determinant): The firm is focused on offering high quality food to its customers. High quality standards drive growth. Periodic weekly quality checks, external certifications from government food inspectors and other recognized agencies would also be required to be met. A formal record of quality issues identified by either the customer or team would help identify quality related issues. Non-compliance may require immediate attention of the management. For customer facing staff, periodic training programs can be initiated to educate the staff with people management skills. Therefore, Fresh Foods should focus on both product and service quality parameter and continuously work on improving them.

(d) Innovation (determinant): Healthy yet delectable vegetarian and vegan food choices is the unique selling point of Fresh Foods. This requires innovative efforts from qualified and skilled chefs. Segregation of the menu into various classes such as A, B, C and D based on popularity and profitability would help the management identify the food choices to focus on.

Innovation has to be constant and not a onetime exercise. Management may review the number of new variants that have been introduced in the menu, regularity of these introductions and customer feedback of the same.

(e) Flexibility (determinant): Growth in scale of operations combined with a competitive business environment implies that the firm should have some flexibility in its operations. The ability to build a robust supply chain that can deal with disruptions is very important for continuity of business operations as well as its future growth. For critical resources such as raw

material, labour etc. the firm should have multiple partners who can provide for the requirements reliably. Appropriate investment in infrastructure in the kitchen, design and décor of the restaurant should be done to build flexibility in operations in order to scale up operations if customer demand picks up.

(f) Resource utilization (determinant): The ability to deliver food within 15 minutes of placing the order requires a high level co-ordination of order taking and food delivery systems. Errors in order taking process, stock outs due to unavailability of material should be avoided at all costs as it causes customer dissatisfaction. Not just this, chefs have to prepare the food economizing costs and minimizing food wastage. They would not just require the requisite skill, but also the right tools in the kitchen to make this happen. Appropriate kitchen infrastructure that can support this providing them with appropriate space, machines and tools for cooking and storage would be needed.

Therefore, some non-financial indicators to be tracked can be overtime / idle time of kitchen, ordering and delivery staff, turnaround time in these functions, table occupancy rate, breakage or wastage of material etc.

Social media platform represents another resource that may need to be used optimally to reach out to the maximum possible existing customers as well as potential ones. This will increase the market share of Fresh Foods.

(II) Standards at Fresh Foods:

(a) Standards are the benchmarks or targets related to the performance metric that is being tracked under each dimension. To be useful, standards should have the following characteristics:

Ownership: A clearly defined organization structure with well-defined roles will help Fresh Food assign authority and responsibility among its staff. This creates ownership for different functions.

Ajay in charge of restaurant operations, Biren in charge of finance, administration and marketing while Chand giving strategic direction and capital infusion clearly defines the role of each of the partners in the firm. They must now decide on the key performance metric that will help them track actual business performance.

Ajay, representing the concerned departments like kitchen and customer service staff, will be accountable for the quality of food and service (Dimension: Determinant; Quality). The formal record of food and service

quality issues can be the basis for setting up appropriate metrics. Stock-outs due to supply chain management issues, non-availability of personnel etc. may also be assigned to Ajay (Dimension: Determinant; Flexibility).

Brien in charge of marketing will be in charge of generating maximum coverage for the business through social media. Number of promotional campaigns and the resultant conversion of potential customers into actual customers, may be a metric for marketing (Dimension: Determinant; Resource utilization). Similarly, ability to get the maximum credit period from suppliers, managing loans at effective rates (Dimension: Determinant; Flexibility*) etc. will be performance parameters Biren regarding the finance function.

(*Can also be related with financial performance)

(b) Achievability: Benchmarks and targets will be useful only if they are achievable. Being a partnership firm, each of the partners have a stake in the performance of the firm. Hence, they would need to have a clear understanding of the benchmarks and targets.

For example, Certain other parameters like the quantity sold and turnover of food choices under each of the Class A, Class B, Class C and Class D categories can also be tracked. (Dimension: Results; Financial Performance and Competitive Performance). Benchmarks can be set as to how many new food choices have been developed (Dimension: Determinants; Innovation) and of those how many have been Class A categories that ones that are profitable as well as popular (Dimension: Results; Competitive Performance).

Being the strategist, Chand can give inputs as to whether these benchmarks and targets are aligned with the firm's overall strategy.

If the target is set very high staff can get de-motivated. If set too low, will not raise the bar for performance. If not in line with the firm's overall strategy, there will be discord or gap between the firm's performance and what it wants to achieve.

(c) Equity: Benchmarks should be equally challenging for all parts of the business. Fresh Foods should customize its performance measure for each function like kitchen staff, order and customer service staff, finance staff, advertising staff etc.

For example, while turnaround time to meet a customer's order would be relevant metric to the kitchen, the effectiveness of promotional campaigns

would be the relevant metric for the marketing department. The rigor of the target should be uniform across departments. Otherwise, the staff would view the benchmark system as being biased towards select functions within the firm.

Similarly, while Ajay and Biren are working partners, they should not view Chand, the non-working partner as a non-contributory resource. As per the current capital structure, Chand equally high stakes in business performance since his capital contribution is five times more than each of the other two partners.

(III) Rewards at Fresh Foods:

This relates to the reward structure within the firm that includes compensation package, bonus, rewards, awards, facilities provided to employees etc. Proper reward system is required for achievement of standards while maintaining costs at optimum levels. Fresh Foods should have a well defined HR policy for compensation, bonus, promotion and reward. A good system should have the following characteristics:

(a) Motivation: Does the reward system drive the people to achieve targets and standards? It is mentioned that high staff attrition is a perennial problem within the industry. Hence, a low reward system for the sake of keeping costs low, would not induce staff to work towards the goal.

While some part of compensation may be fixed, other parts can be made variable. For this, the performance measurement indicators have to be communicated and understood by the staff. For example, bonus of the marketing staff can be aligned to the sales generated, Chefs can be rewarded bonus based on turnover generated by the various categories of food choice as well quality measures etc. Keyman Insurance on key personnel is also a way of motivating and can help stem attrition to a certain extent.

Better job prospects in a growing environment would also be a good motivator. Fresh Foods plans to hire specialist chefs who have scope for innovation within the business mode. Similarly, customer facing staff are going to be given period training on customer management. Management should track various metric in this regard. Reward and recognition systems should act as a good motivator for all of them.

(b) Clarity: Communication and clarity are must for the staff to understand how their compensation package will be driven by the various performance measurement metrics. As regards the partners, they should also have clarity about how each of them will be individually compensated

based on the performance measurement metrics. These can be defined within the partnership deed. Disputes about remuneration (salary, bonus, commission etc.) among the partners can even lead to dissolution of the partnership, which can negatively affect the continuity of business.

(c) Controllability: Unlike the traditional understanding, rewards need not be based only on the financial element that the staff can control. There may be other non-financial elements for which rewards can be given. Both aspects however need to be controllable by the staff concerned. For example, the chef can come up with a popular menu. If the pricing of the product, managed by the partners, is such that it results in a loss to Fresh Foods, the chef may not get the much deserved bonus. This is not a good reward system and might lead to attrition.

In the case of Fresh Foods, the partners have more control over the outcome of results than the staff. This should be used well in order keep the staff motivated while also ensuring requisite business performance.

CASE STUDY 26

In the bustling heart of Kolkata, West Bengal, lies Mantrupti Ltd. (MTL), an unlisted public company established in 1994. They have carved a name for themselves as a distinguished manufacturer and retailer of a diverse selection of coffee and tea powders, catering to a discerning clientele across India.

MTL takes immense pride in its state-of-the-art processing and packaging facility. They source the finest coffee beans and tea leaves from around the world, meticulously selecting them for quality and freshness. Their rigorous production process adheres to stringent quality control measures, ensuring that every cup of coffee or tea brewed from their powders delivers an exceptional taste experience. This unwavering commitment to quality has not only earned them the trust and loyalty of their customers but has also established them as a leading brand in the Indian coffee and tea industry.

Understanding the evolving preferences of their customers, MTL offers a comprehensive range of coffee and tea products. Their portfolio encompasses classic instant coffee blends, aromatic loose leaf teas, and a delightful selection of flavored varieties, catering to diverse palates and brewing preferences. They are constantly innovating and expanding their product offerings, keeping pace with current trends and consumer demands.

With a vision to establish a strong national presence, MTL is actively expanding its distribution network. They are forging partnerships with leading retailers and supermarkets, making their products accessible to a wider customer base across the country. Additionally, they are exploring strategic collaborations and international trade opportunities to broaden their market reach and solidify their position as a prominent player in the global coffee and tea market.

MTL's ability to source the finest coffee beans and tea leaves from around the world gives them leverage in negotiating favorable terms with suppliers. Their meticulous selection process for quality and freshness further strengthens this bargaining position, potentially enabling cost savings and ensuring consistent product quality. However, the bargaining power of buyers cannot be overlooked. Despite MTL's reputation for delivering exceptional taste experiences and its diverse product range catering to various preferences, buyers still wield influence, particularly if they have alternative suppliers to choose from. Therefore, MTL must carefully balance its pricing strategies and value propositions to maintain customer loyalty while safeguarding profitability. By continuously monitoring and adapting to changes in supplier and buyer dynamics, MTL can optimize its supply chain relationships and enhance its competitive edge in the market.

In the competitive landscape of the coffee and tea industry, Mantrupti Ltd. (MTL) faces significant rivalry from both local and international players. With numerous competitors vying for market share, the intensity of competition is palpable. Established brands, as well as emerging players, constantly strive to differentiate themselves through product innovation, pricing strategies, and marketing initiatives. MTL's strong brand reputation, diverse product range, and commitment to quality position it well amidst this competitive milieu. However, the potential for price wars and aggressive marketing tactics looms large, posing challenges to maintaining profitability and market share. To navigate this competitive rivalry effectively, MTL

must leverage its strengths, such as its state-of-the-art processing facility and customer-centric approach, to continuously enhance its offerings and brand value. By staying attuned to market trends, consumer preferences, and competitor actions, MTL can proactively adapt its strategies to outmaneuver rivals and sustain its competitive advantage in the industry.

On July 1st, MTL imported a consignment of coffee beans from Brazil, through establishing contact with such coffee bean supplier situated in Brazil and negotiating the purchase agreement, including price, quality specifications, and delivery terms. Both parties prepared necessary documents, such as a commercial invoice, packing list, bill of lading (ocean freight), and certificate of origin.

MTL has a customs broker, Mr. Deval Kali, to handle the clearance process in India, ensuring compliance with import regulations and duties. The bill of entry for warehousing of goods was presented on 5th July and the goods were duly warehoused. The goods were subject to duty @ 50% ad valorem.

In the meanwhile, on 1st August, an exemption notification was issued reducing the effecting customs duty @ 30%, ad valorem. Mr. Deval on behalf of MTL filed bill of entry for home consumption on 1st September claiming duty @ 30% ad valorem. However, Customs Department charged duty @ 50% ad valorem being the rate on the date of clearance into the warehouse. Also the proper officer raised some queries on the accuracy of the declared value.

Further, the cost of insurance was not ascertainable from the documents submitted before the customs authorities by Mr. Deval on behalf of MTL relevant for determining the CIF price of the imported goods which is obtained by making certain additions to the value of imported goods as prescribed.

MTL is an Ind AS compliant company. It has a paid-up capital of ₹ 5 crores and turnover of ₹ 400 crores. It presents financial results for three years (i.e., one for current year and two comparative years) internally for the purpose of management information every year in addition to the general-purpose financial statements. The aforesaid financial results are presented without furnishing the related notes because these are not required by the management for internal purposes.

During the current year, management thought why not they should present third year statement of profit and loss also in the general-purpose financial statements. It will save time and will be available easily whenever management needs this in future.

MTL is required to file its financial statements through XBRL which enables producers and consumers of financial data to switch resources away from costly manual processes, typically involving time-consuming comparison, assembly and re-entry of data, making the data readable, with the help of two documents: Taxonomy & Instance Document.

The management of MTL on analysis of such additional information, inter-alia, observed that there were variances which arise because of inaccurate or faulty standards, not in control of management, and they should not be held responsible for it.

Further on analysis of such third year statement of profit and loss pertaining to F.Y. 2021-22, it was observed that MTL had issued debentures in the previous year 2021-22, which were to be matured at the end of 5 years. The debenture holder was given an option of one time upfront payment of ₹ 50 per debenture on account of interest which was to be immediately paid by the company. As per the option exercised by the debenture holders, company paid interest upfront to them in the first year itself and the same was claimed as deduction in the return of the company.

But in the accounts, the interest expenditure was shown as deferred expenditure to be written off over a period of 5 years. During the course of assessment, the Assessing Officer spread the upfront interest paid over a period of five year term of debentures and allowed only one-fifth of the amount in the previous year 2021-22, the order for which was issued on 20th May, 2023.

DRT & Co., are the Auditors of MTL, for the year ended on 31/03/2024. The Audit Report for that year was signed by the Auditors on 04/05/2024. The Annual General Meeting was decided to be held during the month of August 2024. On 06/05/2024, the Company had received a communication from the Central Government that an amount of ₹ 300 crore kept pending on account of incentives pertaining to Financial Year 2023-24 had been approved and the amount would be paid to the Company before the end of May 2024.

To a query to Chief Financial officer of the Company, Mr. Rajeev Dutt, by the management, it was informed that this amount had not been recognised in the Audited Financial Statements in view of the same not being released before the close of the Financial Year and due to uncertainty of receipt. Now, having received the amount, the management wished to include this amount in the Financial Statements of the Company for the Financial Year ended on 31/03/2024.

On 08/05/2024, the management amended the accounts, approved the same and requested the auditor to consider this event and issue a fresh Audit Report on the Financial Statements for the year ended on 31/03/2024.

I. Multiple Choice Questions

1. In the case of MTL, amount of cost of insurance would be determined as:

   (i) 20% of free on board value of imported goods

   (ii) 1.125% of free on board value of imported goods

   (iii) Where free on board value is not ascertainable, but sum of free on board value and cost of transport, loading, unloading and handling charges up to place of importation is ascertainable; then 1.125% of such sum

   (iv) Where free on board value is not ascertainable, but sum of free on board value and cost of transport, loading, unloading and handling charges up to place of importation is ascertainable; then 20% of such sum.

Option

(a) (i) or (iii)

(b) (i) or (iv)

(c) (ii) or (iii)

(d) (ii) or (iv)

2. Can management of MTL present the third statement of profit and loss as an additional comparative in the general-purpose financial statements?

   (a) Yes, an entity may present comparative information in addition to the minimum comparative financial statements required by Ind AS, as long as that information is prepared in accordance with Ind AS. However, the entity shall present related note information for those additional statements.

   (b) Yes, but an entity shall present comparative information as at the beginning of the preceding period in addition to the minimum comparative financial statements.

   (c) No, an entity cannot present comparative information in addition to the minimum comparative financial statements required by Ind AS.

   (d) Yes, an entity may present comparative information in addition to the minimum comparative financial statements required by Ind AS, as long as that information is prepared in accordance with Ind AS. The entity does not need to present related note information for those additional statements.

3. Can management of MTL present such third statement of profit and loss only as additional comparative in the general-purpose financial statements without furnishing other components (like balance sheet, statement of cash flows, statement of change in equity) of financial statements?

   (a) No, in such case a complete set of financial statements need to be presented with respect to such third statement of profit and loss in addition to the minimum comparative financial statements required by Ind AS, as long as that information is prepared in accordance with Ind AS.

   (b) Yes, such comparative information may consist of one or more statements as specified but need not comprise a complete set of financial statements.

   (c) No, an entity cannot present only such comparative information at the first place in addition to the minimum comparative financial statements required by Ind AS. So, the question of furnishing other components (like balance sheet, statement of cash flows, statement of change in equity) of financial statements does not arise at all.

(d) No, in such case a complete set of financial statements need to be presented with respect to such third statement of profit and loss in addition to the minimum comparative financial statements required by Ind AS, as long as that information is prepared in accordance with Ind AS. However, the entity may present related note information only for such third statement of profit and loss.

4. MTL is required to file financial statements through XBRL as_____ and XBRL stands for _____

(a) Its paid-up capital and turnover exceeds the prescribed limit and also is an Ind-AS compliant company and XBRL stands for eXtensible Business Reporting Language.

(b) Its paid-up capital and turnover exceeds the prescribed limit and also is an Ind-AS compliant company and XBRL stands for eXtension Business Reporting Language.

(c) Its paid-up capital exceeds the prescribed limit and also is an Ind-AS compliant company and XBRL stands for eXtensible Business Reporting Language.

(d) Its turnover exceeds the prescribed limit and also is an Ind-AS compliant company and XBRL stands for eXtension Business Reporting Language.

5. In the coffee and tea industry, which factor represents the potential challenge of existing competitors intensifying their rivalry by innovating and differentiating their products, thereby posing a threat to Mantrupti Ltd.'s (MTL) market share?

(a) Bargaining Power of Suppliers

(b) Bargaining Power of Buyers

(c) Threat of New Entrants

(d) Competitive Rivalry

II. Descriptive Questions

6. (i) Explain the rate of duty applicable for clearance for home consumption.

(ii) Whether the rate of exchange on 1st August could be adopted for purpose of conversion of foreign currency into local currency?

(iii) Explain briefly the chief reasons on the basis of which the proper officer can raise doubts on the truth or accuracy of the declared value as happened in the case of MTL.

7. Analyse the issues involved and give your views as to whether or not the auditor, DRT & Co., could accede to the request of the management.

8. How do external market dynamics impact Mantrupti Ltd.'s (MTL) strategic choices and competitive stance within the coffee and tea industry? Consider aspects such as the level of competition among industry players, the influence of suppliers and buyers on MTL's operations, the potential threat posed by new market entrants, and the availability of alternative products or substitutes. Evaluate how these factors shape MTL's market positioning and strategic decisions in response to industry challenges and opportunities.

ANSWERS TO THE CASE STUDY 26

I. Answers to the Multiple Choice Questions

1. **(c)** (ii) or (iii)

Reason: For determining the CIF price of the imported goods, certain additions have to be made to the value of imported goods under rule 10(2) of the Customs Valuation (Determination of Value of Imported Goods) Rules, 2007. If cost of insurance is not ascertainable from the documents submitted before the customs authorities, then such amount is determined as follows:

(i) 1.125% of free on board value of imported goods;

(ii) Where free on board value is not ascertainable, but sum of free on board value and cost of transport, loading, unloading and handling charges up to place of importation is ascertainable; then 1.125% of such sum.

2. **(a)** Yes, an entity may present comparative information in addition to the minimum comparative financial statements required by Ind AS, as long as that information is prepared in accordance with Ind AS. However, the entity shall present related note information for those additional statements.

Reason: Yes as per Para 38C of Ind AS 1, an entity may present comparative information in addition to the minimum comparative financial statements required by Ind AS, as long as that information is prepared in accordance with Ind AS. This comparative information may consist of one or more statements referred to in paragraph 10 but need not comprise a complete set of financial statements. When this is the case, the entity shall present related note information for those additional statements.

3. **(a)** No, in such case a complete set of financial statements need to be presented with respect to such third statement of profit and loss in addition to the minimum comparative financial statements required by Ind AS, as long as that information is prepared in accordance with Ind AS.

Reason: Yes, as per Para 38C of Ind AS 1, an entity may present comparative information in addition to the minimum comparative financial statements required by Ind AS, as long as that information is prepared in accordance with Ind AS. This comparative information may consist of one or more statements referred to in paragraph 10 but need not comprise a complete set of financial statements. When this is the case, the entity shall present related note information for those additional statements

4. (a) Its paid-up capital and turnover exceeds the prescribed limit and also is an Ind-AS compliant company and XBRL stands for eXtensible Business Reporting Language.

Reason: According to Rule 2 (1) (d) of the Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2015, 'Extensible Business Reporting Language (XBRL)' means a standardised language for communication in electronic form to express, report or file financial information by the companies under the Companies Act, 2013.

According to Rule 3 (1) of the Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2015, the following class of companies shall file their financial statements and other documents under section 137 of the Companies Act, 2013 with the Registrar in e-Form AOC-4 XBRL as per Annexure-I:

(i) Companies listed with stock exchanges in India and their Indian subsidiaries;

(ii) Companies having paid-up capital of five crore rupees or above;

(iii) Companies having turnover of one hundred crore rupees or above;

(iv) All companies which are required to prepare their financial statements in accordance with Companies (Indian Accounting Standards) Rules, 2015.

Here, MTL is an Ind AS compliant company. It has a paid-up capital of ₹ 5 crores and turnover of ₹ 400 crores.

5. (d) Competitive Rivalry

Reason: The correct answer is D) Competitive Rivalry. While all factors in Porter's Five Forces framework are relevant to assessing MTL's competitive landscape, the factor of competitive rivalry specifically refers to the intensity of competition among existing industry players. In the case of MTL, established brands and emerging players constantly strive to differentiate themselves through product innovation, pricing strategies, and marketing initiatives. This intense competition poses a threat to MTL's market share and profitability as rivals vie for dominance. Therefore, competitive rivalry represents a crucial

aspect influenced by Porter's Five Forces in understanding MTL's strategic challenges within the coffee and tea industry.

II. Answers to the Descriptive Questions

6. **(i)** Section 15(1)(b) of the Customs Act, 1962 provides that in the case of goods cleared from a warehouse, rate of duty applicable is the rate of duty in force on the date on which a bill of entry for home consumption in respect of such goods is presented.

In the given case, since, MTL has filed the bill of entry for home consumption on 1st September, rate of duty is the rate prevalent on the said date viz. 30%.

(ii) Third proviso to section 14 of the Customs Act, 1962 provides that the rate of exchange notified by the CBIC as prevalent on the date of presentation of bill of entry for warehousing is the applicable rate of exchange for conversion of foreign currency into local currency.

Therefore, in the given case, rate of exchange that would be prevalent on date of presentation of bill of entry for warehousing i.e. 5th July and not the one prevalent on date of presentation of bill of entry for home consumption i.e., 1st September, would be adopted.

(iii) As per explanation to rule 12 of the Customs Valuation (Determination of Value of Imported Goods) Rules, 2007, the chief reasons on the basis of which the proper officer can raise doubts on the truth or accuracy of the declared value may include:-

(a) the significantly higher value at which identical or similar goods imported at or about the same time in comparable quantities in a comparable commercial transaction were assessed;

(b) the sale involves an abnormal discount or abnormal reduction from the ordinary competitive price;

(c) the sale involves special discounts limited to exclusive agents;

(d) the misdeclaration of goods in parameters such as description, quality, quantity, country of origin, year of manufacture or production;

(e) the non declaration of parameters such as brand, grade, specifications that have relevance to value;

(f) the fraudulent or manipulated documents

7. 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, MTL received an amount of rupees ₹ 300 crore on account of incentives pertaining to year 2023-24 in the month of May 2024 i.e. after finalisation of financial statements and signing of audit report. The management of MTL 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 new audit report subject to date of audit report which should not be earlier than the date of approval of the amended financial statements.

8. External market dynamics play a pivotal role in shaping Mantrupti Ltd.'s (MTL) strategic choices and competitive stance within the coffee and tea industry using Porter Five Forces. The same is discussed below:

(i) **Bargaining Power of Buyers:** The bargaining power of buyers in the coffee and tea industry is moderate. While MTL's commitment to quality and diverse product range attracts customers, buyers still wield influence, particularly if they have alternative suppliers. Price sensitivity and the availability of substitutes can also impact buyers' bargaining power. Therefore, MTL must balance pricing strategies with maintaining customer satisfaction to preserve market share and profitability.

(ii) **Bargaining Power of Suppliers:** MTL's bargaining power with suppliers is relatively high due to its ability to source the finest coffee beans and tea leaves

globally. Their stringent selection process for quality and freshness strengthens their position, enabling them to negotiate favorable terms with suppliers. However, fluctuations in global commodity prices and dependence on specific suppliers could pose challenges and impact MTL's cost structure.

(iii) **Threat of Substitutes:** The threat of substitutes in the coffee and tea industry varies depending on consumer preferences and trends. While coffee and tea have enduring popularity, substitutes such as soft drinks, energy beverages, and health-focused alternatives pose a moderate threat. MTL can mitigate this threat by emphasizing the unique taste, quality, and experience offered by its products, as well as by innovating to meet changing consumer demands

(iv) **Threat of New Entrants:** The coffee and tea industry presents a moderate threat of new entrants for Mantrupti Ltd. (MTL). The market is relatively accessible due to the popularity of these beverages, MTL's established brand reputation, extensive distribution network, and investment in state-of-the-art processing facilities act as barriers to entry. However, innovative startups or established players from related industries could pose a potential threat by introducing new products or leveraging existing resources to penetrate the market.

(v) **Competitive Rivalry:** Competitive rivalry in the coffee and tea industry is intense, with numerous local and international players vying for market share. Established brands and emerging startups continuously innovate to differentiate themselves through product offerings, pricing strategies, and marketing initiatives. MTL's strong brand reputation, diverse product range, and commitment to quality position it well amidst this competition. However, price wars and aggressive marketing tactics remain potential challenges, requiring MTL to continuously adapt and innovate to maintain its competitive edge.

In summary, by understanding and strategically addressing each aspect of Porter's Five Forces, Mantrupti Ltd. (MTL) can navigate the complexities of the coffee and tea industry, capitalize on opportunities, and mitigate threats to sustain its competitive advantage and drive long-term success.

CASE STUDY 27

Anupama Hotels Ltd. operating an all category resort – "THE VILLAS" which is a famous Vacation Property located in the Hills of Shivalik and the Room occupancy is almost full throughout the year. This property was a hot favorite for not only the people of India but also for International tourists. But, unfortunately, due to sudden local crisis in the hills of Shivalik, this property also suffered huge economical losses with very less business and thus, the Board of Directors wanted to either go for putting it on sale or work out a process of restructuring as a measure to improve the economical feasibility of the property. Restructuring is the corporate management term for the act of reorganizing the legal, ownership, operational, or other structures of a company for the purpose of making it more profitable, or better organized for its present needs. Alternate reasons for restructuring include a change of ownership or ownership structure, demerger, or a response to a crisis or major change in the business such as bankruptcy, repositioning, or buyout. Restructuring may also be described as corporate restructuring, debt restructuring and financial restructuring. The underlying object of corporate restructuring is efficient and competitive business operations by increasing the market share, brand power and synergies. In the emerging scenario, joint ventures, alliances, mergers, amalgamations and takeovers are becoming the easiest and quickest way to expand capacities and acquire dominance over the market. They didn't want to sell it as the price quotes they were getting were quite low as they would have got if the conditions were normal. Out of all the offers they have been getting, they have come down to 3 Options and want to discuss them with you to finalise the most feasible option as follows :-

Option :-1

Naman Hotels Ltd. has shown interest in acquiring this Resort Property as they are of the view that they can help each other in the Business with Naman Group's experienced staff and innovative team in collaboration with the beautiful structure and landscape of "THE VILLAS". This business combination can be carried out by setting up a new entity called "the Namupama Villas Ltd." that will issue 50 shares to Anupama Hotels Ltd. shareholders and 100 shares to Naman Hotels Ltd. shareholders in exchange for the transfer of the shares in those entities. The number of shares reflects the relative fair values of the entities before the combination. Also, respective company's shareholders get the voting rights in the Namupama Villas Ltd. based on their respective shareholdings. The timeline, if the deal is finalised, will stand as:-

(a)	Date of shareholder agreement	1st June
(b)	Appointed date as per shareholder agreement	1st April
(c)	Date of obtaining control over the Board representation	1st July
(d)	Date of transfer of shares	1st August

Option:- 2

Another Company – Kavya Hotels Ltd. from a different state wants to acquire Anupama Hotels Ltd. to take charge of the Resort Property with its Managing Director, Miss Kavya Narula, having confidence of pulling the property out of economic losses using her vast experience in the field of Hospitality industry. To substantiate this, they are asked by the Management of Anupama Hotels Ltd. to put forward the financial details of their performance during the F.Y./P.Y. 2023-24 for Anupama Hotel Ltd.'s consideration regarding striking a deal with them w.r.t. "THE VILLAS". The Head Accountant of Kavya Hotels Ltd. wants to discuss some peculiar transactions w.r.t. the Profit/Loss made by the Group with Miss Kavya and other members of the management as follows, before they finalise their books and submit a report of their Financial Performance to Anupama Hotels Ltd. The Head accountant tells them that their group's Statement of Profit and Loss for the previous year ended 31st March, 2024 shows a profit of ₹ 150 lakhs after debiting or crediting the following items:-

(a) Payment of ₹ 0.35 lakh in cash on 20th December 2023 to a local farmer for purchase of daily use vegetables and ₹ 0.30 lakh to a Confectionary Wholesaler on 26th December 2023 for different products.

(b) Contribution towards employees' pension scheme notified by the Central Government under section 80CCD for a sum of ₹ 3 lakhs calculated at 12% of aggregate of basic salary and dearness allowance (forming part of retirement benefits) payable to the employees in terms of employment.

(c) Payment of ₹ 5.50 lakhs towards transportation of various materials procured by the resort to M/s. PQR Transport, a partnership firm, without deduction of tax at source. The firm declares profit under presumptive taxation scheme under section 44AE and has furnished a declaration to this effect. It also furnished its Permanent Account Number in the tender document.

(d) Profit of ₹ 12 lakhs on sale of a plot of land to Divya Limited, a domestic company, the entire shares of which are held by the assessee company. The plot was acquired by Kavya Hotels Limited on 1st June, 2022.

(e) Contribution of ₹ 0.50 lakhs to Indian Institute of Technology with a specific direction for use of the amount for scientific research programme approved by the prescribed authority.

(f) Expense of ₹ 5 lakhs on foreign travel of two directors for a collaboration agreement with a foreign company for a brewery project to be set up. The negotiation did not succeed, and the project was abandoned.

(g) Fees of ₹ 1 lakh paid to independent directors for attending Board meeting without deduction of tax at source under section 194J.

(h) Depreciation charged ₹ 10 lakhs.

After submitting a report on their financial performance, Kavya Group works out on the Acquisition plan of "THE VILLAS" as this - On 1 April 2024, it will acquire 80 percent of the equity interest of Anupama Hotels Ltd. in exchange for cash of ₹ 300 Lakhs. Due to legal compulsion, Anupama Hotels Ltd. will have to dispose off their investments by a specified date such that they will not have sufficient time to market their property to multiple potential buyers. The management of Kavya Hotels Ltd. initially measures the separately recognizable identifiable assets acquired and the liabilities assumed as of the acquisition date in accordance with the requirement of Ind AS. The identifiable assets are measured at ₹ 600 lakhs and the liabilities assumed are measured at ₹ 200 lakhs. Kavya Ltd. engages an independent consultant who determined that the fair value of 20 per cent non-controlling interest in Anupama Hotels Ltd. is ₹ 84 lakhs. Kavya Hotels Ltd. reviewed the procedures it used to identify and measure the assets acquired and liabilities assumed and to measure the fair value of both the non-controlling interest in Anupama Hotels Ltd. and the consideration transferred. After the review, it decided that the procedures and resulting measures are appropriate and it waited for approval from the end of Anupama Hotels Ltd. to move ahead with this plan if they accept their offer.

Option :- 3

The management of Anupama Hotels Ltd. wants you to carry out a special audit of the controls implemented in their Property and suggest them solutions to improve any deficiency in controls or any management incompetencies which might need improvement or replacement to bring back the good old days and the Company could ask its Financers for a Corporate Restructuring based on your Audit report. You suggest them about Risk Based audit and deliberate them about the process of this audit on their request. You tell them that your Audit would be risk-based or focused on areas of greatest risk to the achievement of the audited entity's objectives. Risk-based audit (RBA) is an approach to audit that analyzes audit risks, sets materiality thresholds based on audit risk analysis and develops audit programmes that allocate a larger portion of audit resources to high-risk areas. Risk Based Audit is an essential element of financial audit- both in the attest audit of the financial statements and in the audit of financial systems and transactions including evaluation of internal controls. It focuses primarily on the identification and assessment of the financial statement misstatement risks and provides a framework to reduce the impact to the financial statement of these identified risks to an acceptable level before rendering an opinion on the financial statements. It also provides indicators of risks as a basis of opportunity for improvement of auditee risk management and control processes. This affords an opportunity to the auditee to improve its operations from recommendations on risks that do not have a current impact on the financial statements but impact the audited entity's operational strategies and performance over the longer term. The auditor's objective in a risk-based audit is to obtain reasonable assurance that no material misstatements whether caused by fraud or errors exist in the financial statements. This involves the following three key steps: - Assessing the risks of material misstatement in the financial statements; Designing and performing further audit procedures that respond to assessed risks and reduce the risks of material misstatements in the financial statements to an acceptably low

level; and Issuing an appropriate audit report based on the audit findings and this work is done in three distinct phases. You have three articles in your team and you delegate them the work as – Komal to check and evaluate the controls in the Restaurant & Bar and work on the risks associated while another two articles Sagar & Ritu to help you with the allotted works as follows:-

KOMAL :- During the process of extracting the exception reports in the Restaurant, she observes numerous purchase entries without valid purchase orders. In terms of percentage, about 30% of purchases were made without valid purchase orders and also few purchase orders were validated after the actual purchase. Also there was no reconciliation between the goods received and the goods ordered. She proceeds ahead to check the validity of purchases at account Balance level and follows some specific audit procedures to achieve her objective. Also, she is told that the Resort has a tie up with Hard Coupons Ltd. which sells coupons to general public that are redeemable against specified luxury food products at selected properties and "THE VILLAS" being one of them. Each coupon is sold for value of ₹ 900 but is redeemable for supplies worth ₹ 1,000. She also notices a Working Capital Block relating to GST ITC utilisation by the Hotel. During the current year, they have been awarded a contract for catering in a marriage to be held at Dehradun. They have further subcontracted it for supply of snacks, to be served in the marriage, to Vanraj & Sons, a local caterer of Dehradun. The Head accountant is of the view that they can't avail ITC on such sub-contract.

SAGAR :- Performing client acceptance or continuance procedures; Planning the overall engagement; Performing risk assessment procedures to understand the business and identify inherent and control risks; Identifying relevant internal control procedures and assessing their design and implementation; Assessing the risks of material misstatement in the financial statements , etc.

RITU :- Designing and performing further audit procedures that respond to the assessed risks of material misstatement and will provide the evidence necessary to support the audit opinion.

Finally, you, as the auditor, assess the audit evidence obtained and determine whether it is sufficient and appropriate to reduce the risks of material misstatement in the financial statements to an acceptably low level and hand over your Audit Report to the management of Anupama Hotels Ltd. with all your suggestions and scope for improvements for reviving the economic operations of the their Resort.

THE DECISION:- Considering all the above options and working out on the feasibility of each , the management of Anupama Ltd. chooses to go further with Option No. 3 of going for Corporate Debt Restructuring and request you to frame a scheme to be discussed with their main financers XYZ Bank Ltd. in due time.

I. Multiple Choice Questions

1. Which of following is not an indicator of possible potential misstatement with respect to "Existence" assertion which could be identified while performing audit of Anupama Hotels Ltd?

   (a) Source Documents overstated

   (b) Fictitious transactions entered on source documents

   (c) Processing of transactions is inaccurate.

   (d) Transactions duplicated on source documents

2. The Head Accountant's view with respect to utilisation of ITC on the contract outsourced to Vanraj & Sons is:

   (a) Correct, as ITC is not available on catering service under GST law.

   (b) Incorrect, as ITC is available in case of sub-contracting of catering service as per GST Law.

   (c) Correct, as ITC is available only when catering service is provided by an employer to its employees under a statutory obligation.

   (d) Correct, as ITC on sub-contracting of catering service is not available under GST law.

3. Which two Account Balances are most likely to be affected by the wrongdoings found by Komal while auditing the expenses of the Restaurant?

   (a) Sales invoices and Purchases.

   (b) Inventory & Account Payables.

   (c) Opening & Closing Stocks only.

   (d) Purchases & Account Payables.

4. What is the value of supply of Luxury food coupons as sold by Hard Coupons Ltd. under GST law?

   (a) ₹ 1000.

   (b) ₹ 900.

   (c) ₹ 100.

   (d) Either (a) or (b) depending upon the time of its redemption.

5. Suppose Anupama Hotels Ltd. strikes a deal with Naman Hotels Ltd. as per the plan of Business combination put forward by the latter :-

STATEMENT 1 :- In this case , the ACQUIRER will be Anupama Hotels Ltd. and not Naman Hotels Ltd.

STATEMENT 2 :- 1st July will be considered as the ACQUISITION DATE.

(a) Both the Statements are Incorrect.

(b) Both the Statements are Correct.

(c) Statement 1 is Incorrect while Statement 2 is Correct.

(d) Statement 1 is Correct while Statement 2 is Incorrect.

II. Descriptive Questions

6. Calculate the gain or loss, Kavya Hotels Ltd. will make on acquisition of Anupama Hotels Ltd., if their deal is finalised. Also show the Journal entries for accounting of its acquisition. Also calculate the value of the non-controlling interest in Anupama Hotels Ltd. on the basis of proportionate interest method, if alternatively applied and resulting goodwill/gain on bargain purchase?

7. "Auditors are required to assess the risks of material misstatement at two levels". Briefly explain the same and state the procedures to be followed by Komal regarding validity of account balances relating to the purchases while auditing the controls in the restaurant of Anupama Hotels Ltd.

8. With the help of data provided by the Head Accountant of Kavya Hotels Ltd. and the following additional information, compute profits and gains of business or profession of Kavya Hotels Limited for the Assessment Year 2024-25 indicating the reason for treatment of each item assuming that the company is not eligible for deduction u/s 35AD. Ignore the provisions relating to minimum alternate tax and the provisions of section 115BAA:-

(a) As a corporate debt restructuring arrangement, their bank has converted unpaid interest of ₹ 10 lakhs upto 31st March 2023 into a new loan account repayable in five equal annual installments. The first installment of ₹ 2 lakhs was paid in March 2024 by debiting new loan account.

(b) Depreciation as per Income-tax Act, 1961 is ₹ 15 lakhs.

(c) The company received a bill for ₹ 3 lakhs on 31st March 2024 from a supplier of vegetables for supply made in March 2024. The bill was omitted to be recorded in the books in March 2024. The bill was paid in April 2024 and the necessary entry was made in the books then.

ANSWERS TO THE CASE STUDY 27

I. Answers to the Multiple Choice Questions

1. **(c)** Processing of transactions is inaccurate.

Reason:

Possible potential misstatements - Indicators

Completeness	• Transactions not identified. • Source documents not prepared. • Source documents not captured. • Rejected source documents not represented
Existence	• Fictitious or unauthorised transactions entered on source documents. • Source documents overstated. • Transactions duplicated on source documents. • Capture of source documents duplicated. • Invalid source documents captured on subsidiary ledgers.
Recording	• Source documents captured inaccurately. • Processing of transactions is inaccurate. • Inaccurate adjustments made in subsidiary ledgers.
Cut-Off Procedures	• Transactions that occur in one period are recorded in another period.

2. **(b)** Incorrect, as ITC is available in case of sub-contracting of catering service as per GST Law.

Reason: ITC on such goods and/or services is allowed in the case of sub-contracting, i.e. when such goods and/or services are used by the taxpayer who is in the same line of business, e.g. outdoor catering service availed by another outdoor caterer.

3. **(d)** Purchases & Account Payables

Reason: Assertions relating to validity of Purchases is being checked.

4. (a) ₹ 1,000

Reason: In terms of rule 32(6) of the CGST Rules, 2017 relating to valuation, the value of a coupon is redeemable against a supply of goods shall be equal to the money value of the goods redeemable against it. Therefore, though the coupon is sold for ₹ 900, its value is ₹ 1,000.

5. (c) Statement 1 is Incorrect while Statement 2 is Correct.

Reason: **STATEMENT 1**:- As per para B15 of Ind AS 103, in a business combination effected primarily by exchanging equity interests, the acquirer is usually the entity that issues its equity interests. However, in some business combinations, commonly called 'reverse acquisitions', the issuing entity is the acquiree. Other pertinent facts and circumstances shall also be considered in identifying the acquirer in a business combination effected by exchanging equity interests, including the relative voting rights in the combined entity after the business combination. The acquirer is usually the combining entity whose owners as a group retain or receive the largest portion of the voting rights in the combined entity. In above mentioned para, acquirer shall be the either of the combining entities (i.e. Naman Hotels Limited or Anupama Hotels Limited) whose owners as a Group retain or receive the largest portion of the voting rights in the combined entity. Hence in the above scenario Naman Hotels Limited shareholder gets 67% Share [(100/150) x 100] and Anupama Hotels Limited shareholder gets 33% share in the Namupama Villas Limited. Hence Naman Limited is acquirer as per the principles of Ind AS 103.

STATEMENT 2 :- In this case, as the control over financial and operating policies are acquired through obtaining board representation on 1st July, it is this date that is considered as the acquisition date. It may be noted that the appointed date as per the agreement is not considered as the acquisition date, as Naman Hotels Ltd. did not have control over Anupama Hotels Ltd. as at that date.

II. Answers to the Descriptive Questions

6. The amount of Anupama Hotels Ltd. identifiable net assets [₹ 400, calculated as ₹ 500 - ₹ 100) exceeds the fair value of the consideration transferred plus the fair value of the non controlling interest in Anupama Hotels Ltd. [₹ 384 calculated as 300 + 84]. Kavya Hotels Ltd. measures the gain on its purchase of the 80 per cent interest as follows:

		₹ in lakh
Amount of the identifiable net assets acquired (₹ 600 - ₹ 200)		400

Less: Fair value of the consideration transferred for Kavya Hotels Ltd. 80 per cent interest in Anupama Hotels Ltd.	300	
Add: Fair value of non controlling interest in Anupama Hotels Ltd.	84	(384)
Gain on bargain purchase of 80 per cent interest		16

Journal Entry

	₹ in lakhs	₹ in lakhs
Identifiable assets acquired Dr.	600	
To Cash		300
To Liabilities assumed		200
To OCI/Equity-Gain on the bargain purchase		16
To Equity-non controlling interest in Anupama Hotels Ltd.		84

Alternatively if the acquirer chooses to measure the non-controlling interest in Anupama Hotels Ltd. on the basis of its proportionate interest in the identifiable net assets of the acquiree, the recognized amount of the non-controlling interest would be ₹ 80 Lakhs (₹ 400 x 0.20). The gain on the bargain purchase then would be ₹ 20 lakhs (₹ 400- (₹ 300 + ₹ 80)

7. (a) Auditors are required to assess the risks of material misstatement at two levels :-

- The first is at the overall financial statement level, which refers to risks of material misstatement that relate pervasively to the financial statements as a whole and potentially affect many assertions.
- The second relates to risks identifiable with specific assertions at the class of transactions, account balance, or disclosure level. This means that for each account balance, class of transactions and disclosure, an assessment of risk (such as high, moderate, or low) should be made for each individual assertion being addressed.

(b) Audit Procedures: The following procedures by Komal may address the validity of the account balance:-

- Make a selection of the purchases, review correspondence with the vendors, purchase requisitions (internal document) and reconciliations of their accounts.
- Review Vendor listing along with the ageing details. Follow up the material

amounts paid before the normal credit period and analyse the reasons for exceptions.

- Meet with the company's Purchase officer and obtain responses to our inquiries regarding the purchases made without purchase orders.
- Discuss the summary of such issues with the client.

8. Computation of Profits and Gains of Business or Profession of Kavya Hotels Ltd. for the A.Y. 2024-25

Particulars		Amount (₹)	
Profit as per Statement of profit and loss			1,50,00,000
Add: Items debited but to be considered separately or to be disallowed			
(a)	Payment to middleman for purchase of vegetables, etc. in an amount exceeding ₹ 10,000	30,000	
	[Under section 40A(3), disallowance is attracted in respect of expenditure for which cash payment exceeding ₹ 10,000 is made on a day to a person. Payment of ₹ 35,000 to farmer for purchase of vegetables is covered by exception under Rule 6DD. However, payment of ₹ 30,000 to confectionery wholesaler is not covered under the exception - CBDT Circular 27/2017 dated 3/11/2017].		
(b)	Contribution towards employees' pension scheme in excess of 10% of salary disallowed under section 40A(9)	50,000	
	[Contribution to the extent of 10% of salary (basic salary + dearness allowance, if it forms part of pay for retirement benefits) is allowable as deduction under section 36(1)(iva)]		
(c)	Payment to transport contractor without deduction of tax at source	-	
	[Since the contractor declares profit under presumptive taxation scheme under section 44AE and furnished a declaration to this effect, tax is not required to be deducted at source under section 194C in respect of payment to transport contractor].		
(e)	Contribution to IIT for scientific research	-	

	[Contribution to IIT for scientific research programme approved by the prescribed authority qualifies for deduction @100% under section 35(2AA). Since the amount of contribution has already been debited to the statement of profit and loss, there is no further adjustment required]		
(f)	Expenses on foreign travel of two directors for a collaboration agreement which failed to materialize	5,00,000	
	[Where expenditure is incurred for a project not related to the existing business and the project was abandoned without creating a new asset, the expenses are capital in nature as per *Mc Gaw-Ravindra Laboratories (India) Ltd. v. CIT (1994) 210 ITR 1002 (Guj.)*. Brewery project is not related to the existing business of running hotels]		
(g)	Fees paid to directors without deducting tax at source [30% of ₹ 1 lakh]	30,000	6,10,000
	[Disallowance @ 30% would be attracted under section 40(a)(ia) for non-deduction of tax at source from director's remuneration on which tax is deductible under section 194J]		
			1,56,10,000
Less: Items credited but to be considered separately/ Expenditure to be allowed			
(d)	Profit on sale of plot of land to 100% subsidiary	12,00,000	
	[Short-term capital gains arise on sale of plot of land held for less than 24 months. However, in this case, since the transfer is to a 100% subsidiary company and the subsidiary company is an Indian company, the same would not constitute a transfer for levy of capital gains tax as per section 47(iv). Since this amount has been credited to the statement of profit and loss, the same has to be deducted for computing business income].		
(h)	Depreciation	5,00,000	
	[Depreciation allowable under the Income-tax Act, 1961 is ₹ 15 lakhs whereas the depreciation as per books of account debited to the statement of profit and loss is ₹ 10 lakhs. Hence, the		

	additional amount of ₹ 5 lakhs has to be deducted while computing business income]		
(i)	Interest paid during the year [Conversion of unpaid interest into loan shall not be construed as payment of interest for the purpose section 43B. The amount of unpaid interest converted into a new loan will be allowable as deduction only in the year in which such converted loan is actually paid. Since ₹ 2 lakhs has been paid in the P.Y. 2023-24, the same is allowable as deduction]	2,00,000	
(iii)	Purchases omitted to be recorded in the books [Since the purchase is made in March, 2024 (i.e., P.Y.2023-24), in respect of which bill of ₹ 3 lakhs received on 31.3.2024 has been omitted to be recorded in the books in that year, it has to be deducted to compute the business income [*Kedarnath Jute Manufacturing Company Ltd. v. CIT (1971) 82 ITR 363 (SC)*]. It is logical to assume that the company is following mercantile system of accounting.]	3,00,000	22,00,000
Income under the head "Profits and Gains of Business or Profession"			1,34,10,000

CASE STUDY 28

BL Limited is a bio-technology and pharmaceutical company that is listed on the National Stock Exchange (NSE). It is a small cap company engaged in research and development, manufacturing and marketing of pharmaceutical formulations and vaccines in India. It has a factory in Vadodara, Gujarat. The company commenced business in the year 2020-21. Growth has been steady and the business is profitable, although in the past few years, the entire pharma industry has been growing at a slower pace as compared to the previous years.

In the last one year, there have been changes in the management. In the previous years, conventional parameters like EPS and share price was used to assess performance. The new management team wish to assess performance on a value based model in addition to the conventional parameters. Below are the financial data for BL Ltd.:

Particulars	**2023-24**	**2022-23**
Profit After Interest and Tax	5,00,00,000	6,00,00,000
Interest	1,00,00,000	2,40,00,000
Opening Capital Employed	3,00,00,000	2,00,00,000
Closing Capital Employed	4,00,00,000	3,00,00,000
	Debt to Equity	**Debt to Equity**
Capital structure	40:60	40:60
	%	%
Costs of capital		
Equity	15.00%	18.00%
Debt (pre-tax-rate)	8%	6%
Tax rate	30%	30%
Stock market information		
Average number of shares in issue	50,000	50,000
Nifty 500 Index	18,000	20,000
Nifty Pharma sector index	16,000	18,000
Boline (share price)	25,00	30,00

The management is keen on increasing the company's potential to generate value sustaining business. Hence, it has felt the need to measure performance so that periodic assessments can be made. The management of BL Limited wants to adopt the Balanced Scorecard framework to

link performance measures with business perspective. At the management meeting, the following targets have been set out:

1. Improve Earning Per Share and Share Price by 15% in the coming year.
2. Enter new market segments where existing drug formulations can be sold.
3. Improve production capacity by 30% in order to support increased sales in the new market segments.
4. Hire experienced experts in the fields of pharmaceutical and bio-technology research in order to make innovative, impactful drug formulations that can capture new markets.

CA Shirish has been appointed as the auditor for the year 2023-24. This is the first year of audit that CA Shirish would be performing for BL Limited. In the financial statements as of March 31,2024, BL Limited has inventories that are material. CA Shirish is attending the physical inventory count as on March 31, 2024. However, during the course of the audit he did find certain drawbacks in the internal controls related to inventory. Therefore, he wishes to ensure that the opening inventory balances as of April 1, 2023 are free of misstatements that can materially affect the current financial statement.

It has an in-house research and development facility within its factory premises that has been approved by the prescribed authority. During the financial year 2023-24, the company incurred ₹5 crores on scientific research, the details of which are given below:

Revenue expenses ₹1 crore

Capital expenditure (machinery and equipment) ₹2 crore

Capital expenditure (land) ₹1 crore

Expenditure on clinical drug trial ₹1 crore

I. Multiple Choice Questions

1. How can EVA of BL Limited be improved?
   (a) Operating profits can be improved without investing more capital
   (b) Choose projects where additional infusion of capital gives a return that is less than the cost of obtaining this additional capital
   (c) Discontinue projects where the return on investments yield more than the cost of capital
   (d) Change the cost of capital to reflect EVA that is favourable
2. Compute the amount of deduction that the company can avail for the scientific research expenditure incurred in the year 2023-24. The company has not opted for the provisions of section 115BAA/115BAB.

(a) ₹5 crores

(b) ₹4 crores

(c) ₹3 crores

(d) ₹1 crores

3. BL Limited has developed 8 new drug formulations in the current year. Which of the following performance indicators will be appropriate for to measure the Critical Success Factor of developing commercially successful innovative drug formulations?

(a) Percentage of profit earned from launch of new drug formulations

(b) Number of new drug formulations launched during the year

(c) Investment in research and development

(d) Market share of the company

4. Using the balance scorecard framework, link performance measures to the four business perspectives.

Sr. No.	Business measure	Sr. No.	Business Perspective
1	Improve Earning Per Share and Share Price by 15% in the coming year.	A	Learning and Growth Perspective
2	Enter new market segments where existing drug formulations can be sold.	B	Internal Business Perspective
3	Improve production capacity by 30% in order to support increased sales in the new market segments.	C	Customer Perspective
4	Hire experienced experts in the fields of pharmaceutical and bio-technology research in order to make innovative, impactful drug formulations that can capture new markets.	D	Financial Perspective

(a) 1-A, 2-B, 3-C, 4-D

(b) 1-D, 2-C, 3-A, 4-B

(c) 1-D, 2-C, 3-B, 4-A

(d) 1-A, 2-C, 3-B, 4-D

5. BL Limited has identified a critical success factor (CSF) for its organization: "Have an excellent quality product" Which of the following would be the most suitable key performance indicator for this CSF?

   (a) Reduce the number of defects identified by quality control and customers by 15%

   (b) Reduce the average time taken to deal with complaints about quality by 10%

   (c) Increase sales by 15% over the next year

   (d) Increase the number of training hours for the company's staff

II. Descriptive Questions

6. Assess the performance of BL Ltd. using Economic Value Added (EVA) method. Assumptions, if any, should be clearly stated.

   Analyse the result of earning per share (EPS) and share market information.

   Evaluate the broader performance of BL Limited considering EVA, EPS and Share Market information.

7. Enumerate whether CA Shirish has any responsibility towards opening inventory balances as on April 1, 2023.

   What will be the responsibilities of CA Shirish in each of the following cases:

   (i) He is unable to obtain sufficient appropriate audit evidence regarding the opening balance of inventory.

   (ii) On obtaining appropriate audit evidence, CA Shirish concludes that the opening balance inventory contains misstatements that can materially affect the current year's financial statements and these misstatements are not adequately presented or disclosed.

   (iii) On obtaining appropriate audit evidence, CA Shirish concludes that the current year's accounting policies have not been consistently applied in relation to opening balances or that the changes in accounting policy is not properly accounted for.

ANSWERS TO THE CASE STUDY 28

I. Answers to the Multiple Choice Questions

1. (a) Operating profits can be improved without investing more capital

Reason: EVA can be improved when operating profits can be improved without investing more capital (that is more efficiency is build into the business operations).

In statement (b), the return on capital infused should be more than the cost of additional capital. In statement (c), projects where return is less than cost of capital need to be discontinued. Statement (d) implies that the cost of capital should be manipulated to reflect a favourable EVA, which is not ethical.

2. (b) ₹ 4 crores.

Reason: Under section 35(2AB) of the Income-tax Act, 1961, BL Limited, a bio-technology and pharmaceutical company, can claim deduction of any expenditure on scientific research incurred on in-house research and development facility approved by the prescribed authority. However, expenditure in the nature of cost of land or building will not be allowed. Expenditures on clinical drug trials is an allowable expenditure.

3. (a) Percentage of profit earned from launch of new drug formulations

Reason: Percentage of profit earned from launch of new drug formulations will indicate if each of the new launch has been commercially successful or not. While option (b) indicates the number of new product launches, it does not capture if these launches have been commercially successful to the company in terms of earning profits. Option (c) & (d) -Investment in research and development and market share of the company does not indicate the commercial viability of the product.

4. (c) 1-D, 2-C, 3-B, 4-A

Reason:

(1) Improve Earning Per Share and Share Price by 15% in the coming year. – Financial Perspective

(2) Enter new market segments where existing drug formulations can be sold. – Customer Perspective

(3) Improve production capacity by 30% in order to support increased sales in the new market segments. – Internal Business Perspective

(4) Hire experienced experts in the fields of pharmaceutical and bio-technology research in order to make innovative, impactful drug formulations that can capture new markets. – Learning and Growth perspective

5. (a) Reduce the number of defects identified by quality control and customers by 15%

Reason: Reduce the number of defects identified by quality control and customers by 15% will improve the quality of the product.

Reduction in the average time taken to deal with complaints about quality by 10%, will in itself not improve the quality of the product. Increase sales by 15% over the next year does not imply that the quality of the product is excellent. Increasing the number of training hours for the company's staff is very generic, as it might not have a direct impact on quality.

II. Answers to the Descriptive Questions

6. Calculation of Economic Value Added (EVA):

Particulars	2023-24	2022-23
Profit After Interest and Tax	5,00,00,000	6,00,00,000
Add Interest (net of tax @ 30%)	70,00,000	1,68,00,000
Net Operating Profit after Tax (NOPAT)	5,70,00,000	7,68,00,000
Opening Capital Employed	3,00,00,000	2,00,00,000
WACC(refer working note 1)	11.24%	12.48%
Cost of capital Capital Employed * WACC	33,72,000	24,96,000
EVA = NOPAT – (Capital Employed* WACC)	5,36,28,000	7,43,04,000

Assumptions:

- There are no non-cash expenses to adjust the profit
- Economic depreciation and accounting depreciation are the same
- No lease exists for capitalization

Working Note 1: Calculation of WACC

WACC for the year 2022-23 = Proportion of Equity * cost of equity + Proportion of Debt * cost of debt (post tax) = 60% * 18% + 40% * (6%*(1-30%)) = 10.80% + 1.68% = 12.48%

WACC for the year 2023-24 = Proportion of Equity * cost of equity + Proportion of Debt * cost of debt (post tax) = 60% * 15% + 40% * (8%*(1-30%)) = 9% + 2.24% = 11.24%

Assessment of EVA:

BL Ltd. has generated positive EVA of ₹ 5,36,28,000 for the year 2023-24. This is much lower than the EVA of the previous year ₹ 7,43,04,000. The value generated is lower by 27.83% ((₹ 7,43,04,000-₹ 5,36,28,000)/ ₹ 7,43,04,000). While this is a concern, it should be noted that lower EVA is not the same as negative EVA. BL Limited did generate positive value during the year 2023-24 although lower than the previous year. Hence, it is an acceptable performance.

Analysis of Earning Per Share (EPS):

The EPS for the year 2023-24 reduced by 16.67% from ₹ 1,200 per share in the previous year to ₹ 1,000 per share. For an investor's standpoint, this not a favourable performance.

Working note 2: Calculation of Earning Per Share (EPS)

Particulars	2023-24	2022-23
Profit After Interest and Tax	5,00,00,000	6,00,00,000
Average number of shares in issue	50,000	50,000
Earning per share(EPS)	1000	1200

Analysis of Stock Price and Index:

The Nifty 500 Index has dropped lower by 10% between the years 2023-24 while the Nifty Pharma Sector Index dropped by 11.11%. This indicates a downturn in the broader stock market scenario as well as in the pharma sector scenario. In comparison, the share price of BL Limited declined by 16.67% during the same period. This shows that the downturn with the company is specifically more than the broad market and industry trends. This is not a favourable performance metric as it shows shareholders are perhaps not very optimistic about the future performance of the company.

Working note:

Index and Share Price Movement	2023-24	2022-23	Change
Nifty 500 Index	18,000	20,000	10.00%
Nifty Pharma sector index	16,000	18,000	11.11%
BL (share price)	25	30	16.67%

Performance of BL Limited with respect to EVA, EPS and Share Market information.

BL Limited has created positive value for its shareholders by generated an EVA of ₹ 5,36,28,000. However, the performance based on EPS and Share market information indicate that the company is facing higher downturn prospects as compared to the over all industry and the market. The fall in EVA by 27.83% and the 16.67% fall in EPS are indicators that the company specific performance is worse than the overall market and the pharma industry. This negative sentiment can be further inferred by the fall in share price of BL Limited by 16.67% during the same period.

7. As per SA 510, one of the objectives of an audit is to obtain sufficient evidence about whether opening balances contain misstatements that can materially affect the current year's financial statements. Audit procedures have to be performed that can provide relevant evidence regarding opening balances.

In the case of inventories, the closing inventory balance cannot provide appropriate evidence regarding the inventory on hand at the beginning of the year. Therefore, CA Shirish will have to perform additional audit procedures that can provide sufficient audit evidence. These may include;

- Observing the current physical inventory count, which CA Shirish is already doing as on March 31, 2024.
- Reconciling closing inventory quantities to opening inventory quantitates.
- Performing audit procedures on the valuation of the opening inventory items
- Performing audit procedures on gross profit and cut off.

(i) Where CA Shirish is unable to obtain sufficient appropriate audit evidence regarding opening balances, he should issue a qualified opinion or disclaimer of opinion in the audit report as is appropriate in the circumstances. (SA 705)

(ii) Where CA Shirish concludes that the opening inventory balance contains a misstatement that can materially affect the current year's financial statement and these misstatements are not adequately presented or disclosed, he should issue a qualified opinion or adverse opinion in the audit report as is appropriate in the circumstances. (SA 705)

(iii) Where CA Shirish concludes that the current year's accounting policies have not been consistently applied in relation to opening balances or that the changes in accounting policy is not properly accounted for, he should issue a qualified opinion or adverse opinion in the audit report as is appropriate in the circumstances. (SA 705).

In addition, in each of the above situations, as part the audit procedure CA Shirish should communicate with the management or those charged with governance.

CASE STUDY 29

YK & Associates is a reputable firm of Chartered Accountants, with its headquarters situated in the vibrant city of Jaipur, Rajasthan. Founded by CA. Yashdeep and CA. Karan, the firm has established itself as a trusted entity in the field of accounting and financial consultancy within the region.

Led by the expertise and vision of its partners, YK & Associates offers a comprehensive range of professional services tailored to meet the diverse needs of its clients. From auditing and taxation to financial advisory and compliance, the firm prides itself on delivering reliable solutions that drive business success.

With a deep understanding of both local regulations and global market dynamics, YK & Associates serves a diverse clientele spanning across industries such as manufacturing, hospitality, retail, and more. Whether assisting startups in navigating regulatory frameworks or providing strategic insights to established enterprises, the firm's commitment to excellence remains unwavering.

Beyond its professional endeavors, YK & Associates actively engages in initiatives aimed at contributing to the local community and promoting financial literacy. Through seminars, workshops, and pro bono services, the firm strives to empower individuals and businesses with the knowledge needed to make informed financial decisions.

YK & Associates get their website developed as www.YKassociates.com from Adarsh Tech Ltd.

The colour of their website was very bright and attractive to run on a “push” technology. Names of the partners of the firm and the major clients were also displayed on the web-site without any disclosure obligation from any regulator.

In exchange of consideration of developing website by Adarsh Tech Ltd., CA. Yashdeep, accepted appointment as its tax auditor, for A.Y. 2024-25 and commenced the tax audit within four days of appointment since the client was is in a hurry to file return of income before the due date.

After commencing the audit, CA. Yashdeep realised his mistake of accepting this tax audit without sending any communication to the previous tax auditor. In order to rectify his mistake, before signing the tax audit report, he sent a registered post to the previous auditor and obtained the postal acknowledgement.

Adarsh Tech Ltd. filed its income tax return for the A.Y. 2024-25 duly on September 30th, 2024. The Income-tax Department processed the return and sent an intimation to Adarsh Tech Ltd.

Despite the intimation, the return was selected for regular assessment for which the notice was served to the company within the time limit as well as the order was passed by the Assessing Officer (below the rank of Joint Commissioner). However, Adarsh Tech Ltd. was aggrieved by the amount of income assessed in the order passed under regular assessment.

Jaipur Municipal Corporation (JMC) had invited online bids for development of online cloud system, for maintaining some vital statistics including registration of births and deaths, within the pre-defined period as per the contract. The work involved composite supply of goods and services wherein the supply of services was the principal supply.

The value of goods (in form of computer hardwares) constituted 25% of the total value of composite supply. Mr. Arsh, Managing Director of Adarsh Tech Ltd., located and registered under GST in Jaipur, wanted to bid for the same.

Mr. Arsh wanted investment advisory services from YK & Associates for investing the surplus funds of Adarsh Tech Ltd. for which purpose he had invited Mr. Yashdeep for a meeting. In the meeting, Mr. Yashdeep explained the benefits of investing in mutual fund schemes along with its drawbacks and also recommended investing in xscheme Purnarth floated by HMKD Plus Mutual Fund managed by his own friend. The details of such scheme are as follows:

HMKD Plus Mutual Fund had the following assets in Scheme Purnarth at the close of business on 31st March, 2024.

Company	No. of Shares	Market Price Per Share
Nepathya Ltd.	25,000	20
D-Con Ltd.	35,000	300
Sarpan Ltd.	29,000	380
Care Health Ltd.	40,000	500

The total number of units of Scheme Purnarth are 12 lakhs. The Scheme Purnarth has accrued expenses of ₹ 1,50,000 and other liabilities of ₹ 3,00,000.

Further, Mr. Yashdeep, in his busy schedule, took some time to attend one another meeting, this time arranged by manager of RFIN Bank, Mr. Ravi, who wanted Mr. Yash's firm to perform an audit of the blockchain-based system, the details of which provided by Mr. Ravi to Mr. Yashdeep, in the said meeting, are as follows:

Bouyanc Bank, headquartered in Chicago, offers a broad range of financial services including asset management, commercial banking, investment banking, and treasury and securities services.

RFIN Bank in partnership with Bouyanc Bank, provide a comprehensive range of banking services and products encompassing retail banking, corporate banking, international banking, and other financial services. RFIN Bank has been significant contributors to the digitalization of banking services in India.

Under the pilot programme, the RFIN bank will open on-chain Nostro accounts with Bouyanc Bank branch in Gift City. The blockchain-based system is expected to facilitate instant, 24×7 settlement between the accounts held at the US bank. Essentially, it will create a private intra-correspondent banking network, redefining the traditional banking hours and enabling seamless money transfer.

Mr. Ravi, the manager of RFIN Bank, gave an order to GM Stores Pvt. Ltd. (GMSPL) on 1st January, 2024 for 1,000 custom-made corporate gifts, to be provided to their prestigious corporate clients along with the information about the aforesaid blockchain-based system.

On 3rd January, 2024 GMSPL purchased raw materials to be consumed in the production process for ₹ 6,50,000, including ₹ 50,000 refundable purchase taxes. The purchase price was funded by raising a loan of ₹ 6,55,000 (including ₹ 5,000 loan-raising fees). The loan is secured by the inventories.

During January, 2024 GMSPL designed the corporate gifts for the customer bank. Design costs included:

- cost of external designer = ₹ 6,000; and
- labour = ₹ 4,000.

During February, 2024, GMSPL's production team developed the manufacturing technique and made further modifications necessary to bring the inventories to the conditions specified in the agreement. The following costs were incurred in the testing phase:

- materials, net of ₹ 3,000 recovered from the sale of the scrapped output = ₹ 21,000
- labour = ₹ 11,000
- depreciation of plant used to perform the modifications = ₹ 5,000

During February, 2024, GMSPL incurred the following additional costs in manufacturing the customised corporate gifts:

- consumable stores = ₹ 55,000
- labour = ₹ 65,000
- depreciation of plant used to manufacture the customised corporate gifts = ₹ 15,000

The customised corporate gifts were ready for supply on 1st March, 2024. No abnormal wastage occurred in the development and manufacture of the corporate gifts.

I. Multiple Choice Questions

1. Whether, website designed for www.YKassociates.com is in compliance with the guidelines given in Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949:

   (a) Yes, website can have names of partners and major clients along with its fees.

   (b) Yes, as the websites can be designed on a "push" technology.

   (c) Yes, as there is no restriction on the colours used in the website.

   (d) No, as names of the major clients were displayed without any disclosure obligation from any Regulator.

2. Before signing the tax audit report, CA. Yashdeep sent a registered post to the previous auditor and obtained the postal acknowledgement. Will CA. Yashdeep be held guilty of professional misconduct under the Chartered Accountants Act, 1949?

   (a) As per Clause (8) of Part I of First Schedule to the Chartered Accountants Act, 1949 CA. Yashdeep will not be held guilty of professional misconduct as he communicated with the previous tax auditor before signing the audit report.

   (b) As per Clause (8) of Part I of First Schedule to the Chartered Accountants Act, 1949, CA. Yashdeep will not be held guilty of professional misconduct since the requirement for communicating with the previous auditor being a chartered accountant in practice would apply to statutory audit only.

   (c) As per Clause (8) of Part I of First Schedule to the Chartered Accountants Act, 1949, CA. Yashdeep will be held guilty of professional misconduct since he has accepted the tax audit, without first communicating with the previous auditor in writing.

   (d) As per Clause (8) of Part I of Second Schedule to the Chartered Accountants Act, 1949, CA. Yashdeep will be held guilty of professional misconduct since he

has accepted the tax audit, without first communicating with the previous auditor in writing.

3. Adarsh Tech Ltd. approaches you to ascertain the taxability of supply of services of development of online cloud system to JMC, in the given case, for quoting the best price. You are required to determine the taxability of the given supply.

   (a) GST is exempt on said supply since the value of supply of goods constitutes not more than 25% of the value of the said composite supply.

   (b) GST is payable on said supply. It will be exempt if value of supply of goods constitutes less than 25% of the value of the said composite supply.

   (c) GST is payable on said supply. It will be exempt if value of supply of goods constitutes more than 25% of the value of the said composite supply.

   (d) Said supply is neither supply of goods nor supply of services in terms of Schedule III of the CGST Act, 2017.

4. What is the remedy available to Adarsh Tech Ltd. against the order passed by the Assessing Officer and the time limit within which such remedy should be exercised?

   (a) Adarsh Tech Ltd. has to file an appeal before Commissioner (Appeals) u/s 246A within 1 month of the date on which the order sought to be appealed against is communicated to them

   (b) Adarsh Tech Ltd. has to file an appeal before the Appellate Tribunal u/s 253 within 60 days of the date on which the order sought to be appealed against is communicated to them

   (c) Adarsh Tech Ltd. has to file an appeal u/s 246A before Joint Commissioner (Appeals) within 30 days of the date of service of the notice of demand relating to the assessment.

   (d) Adarsh Tech Ltd. has to file an appeal u/s 253 before the Appellate Tribunal within 30 days of the date of service of the notice of demand relating to the assessment.

5. What kind of technology advancement is represented by the scenario involving RFIN Bank's implementation of a blockchain-based system in partnership with Bouyanc Bank?

   (a) Automation

(b) Extension

(c) Transformation

(d) Disruption

II. Descriptive Questions

6. (i) Calculate the NAV per unit of the Scheme Purnarth

(ii) What are the advantages as well as drawbacks of investing in Mutual Funds as would have been narrated by Mr. Yashdeep?

7. In connection with RFIN Bank & Bouyanc Bank, Provide some illustrative steps for performing audit of the aforesaid blockchain-based system.

8. Compute the cost of the inventory of GMSPL? Substantiate your answer with appropriate reasons and calculations, wherever required.

ANSWERS TO THE CASE STUDY 29

I. Answers to the Multiple Choice Questions

1. **(d)** No, as names of the major clients were displayed without any disclosure obligation from any Regulator

Reason: Guidelines for Advertisement pursuant to decision of Council at its 388th Meeting

Disclosure of names of clients and/or fees charged, on the website is permissible only where it is required by a regulator, whether or not constituted under a statute, in India or outside India.

2. **(c)** As per Clause (8) of Part I of First Schedule to the Chartered Accountants Act, 1949, CA. Yashdeep will be held guilty of professional misconduct since he has accepted the tax audit, without first communicating with the previous auditor in writing.

Reason: As per Clause (8) of the Part I of the First Schedule to the Chartered Accountants Act, 1949, a chartered accountant in practice cannot accept position as auditor previously held by another chartered accountant without first communicating with him/her in writing.

3. (a) GST is exempt on said supply since the value of supply of goods constitutes not more than 25% of the value of the said composite supply

Reason: Entry 3A of the Exemption ***Notification No. 12/2017 Central Tax (Rate) dated 28.06.2017***: provides exemption to composite supply of goods and services in which the value of supply of goods constitutes not more than 25% of the value of the said composite supply provided to the Central Government, State Government or Union territory or local authority by way of any activity:

in relation to any function entrusted to a Panchayat under article 243G of the Constitution or

in relation to any function entrusted to a Municipality under article 243W of the Constitution.

Thus, GST is exempt on supply of services of development of online cloud system to JMC, in the given case, for quoting the best price.

4. (c) Adarsh Tech Ltd. has to file an appeal u/s 246 before Joint Commissioner (Appeals) within 30 days of the date of service of the notice of demand relating to the assessment.

Reason: As per section 246 of the Income-tax Act, 1961, on or after 1.4.2023, any assessee aggrieved by any of the following orders of an Assessing Officer (below the rank of Joint Commissioner) may appeal to the Joint Commissioner (Appeals) against an order, *inter alia,* being an intimation under section 143(1), where the assessee objects to the making of adjustments, or any order of assessment under section 143(3) or section 144, where the assessee objects to-

(i) the amount of income assessed, or

(ii) the amount of tax determined, or

(iii) the amount of loss computed, or

(iv) the status under which he is assessed

As per section 249 of the Income-tax Act, 1961, an appeal to Joint Commissioner (Appeals) or to the Commissioner (Appeals) against any order which is appealable is to be presented within 30 days of the date of service of the notice of demand relating to the assessment.

5 (c) Transformation

Reason: The scenario describes the implementation of a blockchain-based system by RFIN Bank in partnership with Bouyanc Bank to facilitate instant settlement between accounts held at the US bank. This initiative represents a significant shift in the traditional banking paradigm and has the potential to redefine the way banking transactions are conducted.

"Transformation" refers to a fundamental change in the way processes, operations, or systems function, often leading to a redefinition of existing practices. In this case, the adoption of blockchain technology fundamentally alters the way banking transactions are processed, moving away from traditional methods towards a decentralized, transparent, and immutable ledger system. This shift disrupts existing processes and workflows within the banking sector, leading to transformative changes in how financial transactions are executed and settled.

II. Answers to the Descriptive Questions

6. (i)

Shares	No. of shares	Price	Amount (₹)
Nepathya Ltd.	25,000	20.00	5,00,000
D-Con Ltd.	35,000	300.00	1,05,00,000
Sarpan Ltd.	29,000	380.00	1,10,20,000
Care Health Ltd.	40,000	500.00	2,00,00,000
			4,20,20,000
Less: Accrued Expenses			1,50,000
Other Liabilities			3,00,000
Total Value			4,15,70,000
No. of Units			12,00,000
NAV per Unit (4,15,70,000/12,00,000)			**34.64**

(ii) ADVANTAGES OF MUTUAL FUND

(a) Professional Management: The funds are managed by skilled and professionally experienced managers backed by a team of Research Analysts.

(b) Diversification: Mutual Funds invest into many securities and offer diversification which reduces the concentration risk.

(c) Convenient Administration: There are no administrative risks of share transfer, as many of the Mutual Funds offer services in a demat form which saves investor's time and prevents delay.

(d) Higher Returns: Over a medium to long-term investment horizon, investors get higher returns in Mutual Funds as compared to other avenues of investment. However, investors are cautioned that such very high returns during the exceptional bull phase of the market like IT boom or Infrastructure boom should not be considered as regular returns and therefore one should look at the average returns provided by the Mutual Funds particularly in the equity schemes over a long period of time.

(e) Low Cost of Management: SEBI has prescribed maximum limit of charging 2.50% for Equity Mutual Funds. No Mutual Fund can increase the cost beyond prescribed limits of 2.5% maximum and any extra cost of management is to be borne by the AMC.

(f) Liquidity: In all the open ended funds, liquidity is provided by direct sales / repurchase by the Mutual Fund and in case of close ended funds, the liquidity is provided by listing the units on the Stock Exchange.

(g) Transparency: The SEBI Regulations now compel all the Mutual Funds to disclose their portfolios on a half-yearly basis. However, many Mutual Funds disclose their Scheme Portfolio on a quarterly or monthly basis to their investors. The NAVs are calculated on a daily basis in case of open ended funds and are published through AMFI in the newspapers.

(h) Other Benefits: Mutual Funds provide systematic withdrawal and systematic investment plans according to the need of the investors. The investors can also switch from one scheme to another without any restrictions except in case of Tax Savings Fund which restricts switch out for first 3 years of its investments.

(i) Highly Regulated: Mutual Funds all over the world are highly regulated and in India all Mutual Funds are registered with SEBI and are strictly regulated as per the Mutual Fund Regulations which provide high level of investor protection.

(j) Economies of scale: The way mutual funds are structured gives it a natural advantage. The "pooled" money from numerous investors ensures that mutual funds enjoy economies of scale; it is cheaper compared to investing directly in the capital markets which involves higher charges. This also allows retail investors access to participation in the Capital Market which otherwise is difficult for them go directly.

(k) Flexibility: One of the biggest advantages of a Mutual Fund Scheme is its flexibility. An investor can opt for Systematic Investment Plan (SIP), Systematic Withdrawal Plan etc. to plan his cash flow requirements as per his convenience. The wide range of schemes being launched in India by different mutual funds also provides an added flexibility to the investor to plan his portfolio accordingly.

(l) Convenience: It is very convenient & easy to invest & disinvest from Mutual Fund Schemes specially through digital transaction portals

(ii) DRAWBACKS OF MUTUAL FUND

(a) No guarantee of Return – There are three issues involved:

(i) All Mutual Funds cannot be winners. There may be some Schemes who may underperform against the benchmark index. However, the Fund Manager will endeavour to give better return than the underlying benchmark Index in the long run.

(ii) A mutual fund may perform better than the stock market but this does not necessarily lead to a similar gain for every investor. This is because of the different entry & exit points for each investor.

(iii) In case of a massive fall in the value of the stocks held in the Portfolio, the investor may lose principal in the short-term e.g., during Global Financial Crisis in 2008 or during outbreak of Covid 19 pandemic in 2020 etc. But if the investment is held for a longer term, the chances of losing principal are very remote & negligible.

(b) Diversification – A mutual fund helps to create a diversified portfolio. Though diversification minimizes risk, it does not ensure maximizing returns. The returns that mutual funds offer is at times lesser than what an investor can earn from a single stock. For example, if a single security held by a mutual fund double in value, the mutual fund itself would not double in value because that security is only one small part of the fund's holdings. By holding a large number of different investments, mutual funds tend to do neither exceptionally well nor exceptionally poor.

(c) Selection of Proper Fund – It may be easy for someone to select the right share rather than the right mutual fund scheme. For stocks, one can rely his selection on the parameters of economic, industry and company analysis. In case of mutual funds, past performance is the one of the most important criteria to fall back upon but the past performance cannot predict the future.

(d) Cost Factor – Every Mutual Fund Scheme charges some fund management fees as a part of Annual Recurring Expenses. Although there are no charges/load on entry, but at times an exit may get charged if withdrawn before a stipulated period, known as "Exit Load". Amount withdrawn after the stipulated period of holding, if withdrawn, doesn't attract any Exit Load. The fees paid to the Asset Management Company is in no way related to performance.

7. Following are the illustrative steps for performing audit of above said block chain:

(a) Obtain a comprehensive understanding of the blockchain-based pilot program, including its objectives, scope, and key processes involved.

(b) Review the partnership agreements, contracts, and legal documentation governing the relationship between the RFIN bank and Bouyanc Bank.

(c) Identify the specific blockchain technology used, its functionalities, and the underlying mart contracts.

(d) Assess Internal Controls:

- Review policies and procedures related to the on-chain Nostro accounts, settlement processes, and money transfer mechanisms.
- Assess the governance framework, risk management practices, and compliance procedures established by the RFIN bank and Bouyanc Bank.

(e) Review Security Measures:

- Assess encryption methods, cryptographic key management, and secure transmission protocols used for data protection.
- Review measures taken to prevent unauthorized access, cyber threats, and potential vulnerabilities in the blockchain network.

(f) Test Transaction Validity and Accuracy:

- Validate that transactions are recorded and settled accurately on the blockchain, ensuring adherence to relevant regulations and contractual obligations.
- Perform reconciliations between on-chain Nostro accounts and the corresponding accounts held at Bouyanc Bank to confirm the accuracy of balances and transactions.

(g) Evaluate Compliance and Regulatory Requirements:

- Review documentation and procedures related to customer due diligence, transaction monitoring, and reporting obligations.
- Ensure that the pilot program adheres to industry-specific standards and best practices.

(h) Assess Business Continuity and Disaster Recovery:

Evaluate the adequacy of backup and recovery procedures, redundancy measures, and failover mechanisms to ensure uninterrupted operations.

Test the effectiveness of these plans by conducting simulations or examining historical incidents and response procedures.

(i) Report Findings and Recommendations:

Provide recommendations for improving internal controls, security measures, compliance procedures, and overall efficiency and effectiveness of the pilot program.

Communicate the audit results to the relevant stakeholders, highlighting areas of concern and suggesting remedial actions.

8. Statement showing computation of inventory cost

Particulars	Amount (₹)	Remarks
Costs of purchase	6,00,000	Purchase price of raw material [purchase price (6,50,000) less refundable purchase taxes (50,000)]
Loan-raising fee	–	Included in the measurement of the liability
Costs of purchase	55,000	Purchase price of consumable stores
Costs of conversion	65,000	Direct costs—labour
Production overheads	15,000	Fixed costs—depreciation
Production overheads	10,000	Product design costs and labour cost for specific customer
Other costs	37,000	Refer working note
Borrowing costs	–	Recognized as an expense in profit or loss
Total cost of inventories	**7,82,000**	

Working Note:

Costs of testing product designed for specific customer:

₹ 21,000 material (i.e. net of the ₹ 3,000 recovered from the sale of the scrapped output) + ₹ 11,000 labour + ₹ 5,000 depreciation = 37,000.

CASE STUDY 30

WDG Ltd., incorporated in 1999, is a public unlisted company headquartered in Surat, Gujarat, India. It has carved a niche for itself in the production of high-quality industrial spare parts catering to a diverse clientele across the manufacturing, construction, and allied industries.

WDG Ltd. boasts a state-of-the-art manufacturing facility equipped with advanced machinery and technology. Their production process adheres to stringent quality control measures, ensuring their spare parts meet the highest standards of durability, functionality, and efficiency. The company's commitment to quality has earned them the trust and loyalty of their customers, establishing them as a reliable and dependable supplier in the industry.

Driven by a customer-centric approach, WDG Ltd. maintains a wide inventory of spare parts to cater to the diverse needs of their clients. Their product portfolio encompasses a comprehensive range of parts, including bearings, gears, seals, and various other components critical for the smooth operation of machinery and equipment. Additionally, they offer custom-made solutions to cater to specific client requirements, ensuring their parts seamlessly integrate into existing machinery.

Looking ahead, WDG Ltd. is committed to continuous innovation and expansion. They actively invest in research and development to stay abreast of the latest advancements in materials and manufacturing techniques. The company also plans to broaden its geographic reach by establishing strategic partnerships and exploring new markets, solidifying its position as a leading player in the industrial spare parts industry.

The company desires to upgrade its production process since the directors believe that technology-led production is the only way the company can remain competitive. On 1 April 2023, the company entered into a property lease arrangement in order to obtain tax benefits. However, the draft financial statements do not show a lease asset or a lease liability as on date.

A new financial manager, Mr. Kartik Desai, a Chartered Accountant, joined WDG Ltd. before the financial year ending 31st March, 2024 and was engaged in the review of financial statements to prepare for the upcoming audit and to begin making a loan application to finance the new technology.

CA. Kartik believes that the lease arrangement should be recognized in the Balance Sheet. However, the Managing Director, Ms. Tina Devan, an MBA, strongly disagrees. She wishes to charge the lease rentals to the Statement of Profit and Loss.

Her opinion is based on the understanding that the lease arrangement is merely a monthly rental payment, without any corresponding asset or obligation, since there is no ‘invoice’ for transfer of asset to WDG Ltd.

Her disagreement also stems from the fact that showing a lease obligation in the Financial Statements would impact the gearing ratio of the company, which could have an adverse impact on the upcoming loan application. Ms. Tina has made it clear to CA. Kartik Desai that at stake is not only the loan application but also his future prospects at WDG Ltd.

Ms. Tina believed that no matter how much authority and autonomy are given to responsibility managers, performance reports are needed to evaluate the performance of the managers at all operating levels of the organization. At bottom levels, it helps in determining what all corrective measures are required in their segments. At top management level, these reports keep them top managers informed on the performance of all segments.

In the said context, to assess the performance of Mr. Kartik's finance department, she wanted internal performance reporting to be done, at the regular intervals, also due to the fact that Mr. Kartik was newly appointed.

Mr. Kartik asked Ms. Tina to call for a meeting of the Board of the company to consider for the investment of surplus funds amounting to ₹ 10 crores of the company. Out of the total strength of six Directors of the company, five were attending the said Board Meeting called by Ms. Tina.

The investment of the said amount was to be made in a project of associate company of WDG Ltd. The risk-free rate of return is 7%. Risk premium expected by Mr. Kartik is 7%. The life of the project is 5 years.

Following are the cash flows that are estimated over the life of the project:

Year	Cash flows (₹ in lakhs)
1	250
2	600
3	750
4	800
5	650

Looking at the financial and taxation knowledge of Mr. Kartik, Ms. Tina asked a favor from him to help her to calculate the deduction available to her under appropriate provisions of the Income-tax Act, 1961 for A.Y. 2024-25, considering the following particulars for the year ending 31.03.2024 if she has opted out of the default tax regime under section 115BAC:

(a) Life Insurance Premium paid – ₹ 20,000, actual capital sum of the policy assured for ₹ 2,80,000. The insurance policy was taken on 31.03.2012;

(b) Contribution to Public Provident Fund – ₹ 30,000 in the name of father;

(c) Tuition fee payment – ₹ 8,000 each for 2 sons pursuing full time graduation course in Surat; Tuition fee for daughter pursuing PHD in Stanford University, USA – ₹ 2.50 lakhs;

(d) Housing loan principal repayment – ₹ 23,000 to Axis Bank. This property is under construction at Surat as on 31.03.2024;

(e) Principal repayment of housing loan taken from a relative – ₹ 80,000. The property is self-occupied situated at Surat;

(f) Five-year time deposit in an account under Post Office Time Deposit Scheme – ₹ 60,000;

(g) Investment in National Savings Certificate – ₹ 60,000

Mr. Kartik had submitted his income tax details to the company for purpose of TDS. He is born on 4.10.1990 and has a gross total income of ₹ 2,50,000 for A.Y.2024-25 comprising of his salary income since he joined WDG Ltd. from January 2024 only.

He pays electricity bills of ₹ 10,000 per month. He made a visit to Melbourne along with his wife for a month in May, 2023 for which he incurred to and fro flight charges of ₹ 1.10 lakhs. The remaining expenditure for his visa, stay and sightseeing amounting to ₹ 90,000 was met by his brother residing in Melbourne.

I. Multiple Choice Questions

1. Which one of the following statements about the type of performance reporting intended to be done by Ms. Tina is true?

   (a) Performance reports are unnecessary for newly appointed managers like Mr. Kartik, as they need time to settle into their roles.

   (b) Internal performance reporting is essential for all operating levels of the organization, including top management, to evaluate the performance of responsibility managers.

   (c) Performance reports are only needed at the top management level to keep them informed about the overall performance of the organization.

   (d) Ms. Tina believes that performance reports should be conducted annually to provide a comprehensive assessment of each department's performance.

2. The resolution relating to investment shall be taken as passed by the Board in which of the following cases:

   (a) When all the five Directors of WDG Ltd. attending the meeting consent to such investment of funds.

   (b) When any four Directors of WDG Ltd. out of five attending the meeting consent to such investment of funds.

   (c) When any three Directors of WDG Ltd. out of five attending the meeting consent to such investment of funds.

   (d) Investment proposal must be consented to by the total strength of six Directors of WDG Ltd.

3. The Net Present Value of the project proposed for making investment based on Risk free rate approximately is…….

   (a) ₹ 2443.40 lakhs

   (b) ₹ 1443.40 lakhs

   (c) ₹ 997.85 lakhs

   (d) ₹ 1997.85 lakhs

4. The Net Present Value of the project proposed for making investment on the basis of Risks adjusted discount rate is:

   (a) ₹ 2443.40 lakhs

   (b) ₹ 1443.40 lakhs

   (c) ₹ 997.85 lakhs

   (d) ₹ 1997.85 lakhs

5. Whether Mr. Kartik is required to file his return of income for A.Y.2024-25, and if so, why?

   (a) No, Kartik is not required to file his return of income

   (b) Yes, Kartik is required to file his return of income, since his gross total income/total income is not less than the basic exemption limit

   (c) Yes, Kartik is required to file his return of income since he pays electricity bills of ₹ 10,000 per month, which exceeds the prescribed annual threshold

   (d) Yes, Kartik is required to file his return of income since he has incurred foreign travel expenditure exceeding ₹ 50,000

II. Descriptive Questions

6. Discuss the potential ethical conflicts which may arise in respect of the lease arrangement and the ethical principles which would guide how the financial manager, Mr. Kartik, should respond to the situation.

7. Compute the deduction available to Ms. Tina under appropriate provisions of the Income-tax Act, 1961 for A.Y. 2024-25.

8. By examining internal capabilities, stakeholder influences, task environment, and broader market dynamics, analyse the strategic position integrated to understand WDG Ltd.'s competitive positioning within the industrial spare parts industry.

ANSWERS TO THE CASE STUDY 30

I. Answers to the Multiple Choice Questions

1. (b) Internal performance reporting is essential for all operating levels of the organization, including top management, to evaluate the performance of responsibility managers.

Reason: Ms. Tina believes that performance reports are necessary for evaluating the performance of managers at all operating levels of the organization. This includes not only bottom-level managers but also those at the top management level. The purpose of these reports is to assess the performance of segments or departments within the organization and determine any corrective measures required. Since Mr. Kartik is newly appointed, it's even more crucial to have regular performance reporting to evaluate the performance of his finance department. Therefore, option B is the correct statement about the type of performance reporting intended to be done by Ms. Tina.

2. (a) When all the five Directors of WDG Ltd. attending the meeting consent to such investment of funds.

Reason: As per Section 186(5) of the Companies Act, 2013, any investment shall be made or loan or guarantee or security given by the company only after when the resolution sanctioning it is passed at a meeting of the Board with the consent of all the directors present at the meeting.

3. (b) ₹ 1,443.40 lakhs

Reason: The Present Value of the Cash Flows for all the years by discounting the cash flow at 7% is calculated as below:

Year	Cash flows (₹ in lakhs)	Discounting Factor @ 7%	Present value of Cash Flows (₹ in lakhs)
1	250	0.935	233.75
2	600	0.873	523.80
3	750	0.816	612.00
4	800	0.763	610.40
5	650	0.713	463.45
Total of Present value of Cash flows			2,443.40
Less: Initial investment			1,000.00
Net Present Value (NPV)			1,443.40

4. (c) ₹ 997.85 lakhs

Reason: When the risk-free rate is 7% and the risk premium expected by the Management is 7%, then risk adjusted discount rate is 7% + 7% = 14%.

Discounting the cash flows using the Risk Adjusted Discount Rate would be as below:

Year	Cash flows (₹ in lakhs)	Discounting Factor @ 14%	Present value of Cash Flows (₹ in lakhs)
1	250	0.877	219.25
2	600	0.769	461.40
3	750	0.675	506.25
4	800	0.592	473.60
5	650	0.519	337.35
Total of Present value of Cash flows			1,997.85
Less: Initial investment			1,000.00
Net Present Value (NPV)			997.85

5. (c) Yes, Kartik is required to file his return of income since he pays electricity bills of ₹ 10,000 per month, which exceeds the prescribed annual threshold.

Reason: Any person other than a company or a firm, who is not required to furnish a return under section 139(1), would have to file income-tax return in the prescribed form and manner on or before the due date if, during the previous year, such person –

(i) has deposited an amount or aggregate of the amounts exceeding ₹ 1 crore in one or more current accounts maintained with a banking company or a co-operative bank; or

(ii) has incurred expenditure of an amount or aggregate of the amounts exceeding ₹ 2 lakh for himself or any other person for travel to a foreign country; or

(iii) has incurred expenditure of an amount or aggregate of the amounts exceeding ₹ 1 lakh towards consumption of electricity; or

(iv) fulfils such other prescribed conditions

II. Answers to the Descriptive Questions

6. As per Ind AS 116, Leases, at the inception of a contract, an entity shall assess whether the contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

In accordance with the above definition, WDG Ltd. must recognise a right-of-use asset representing the property and a corresponding lease liability for the obligation to make lease payments. At the commencement date, the right-of-use asset so recognised would include:

- The amount of the initial measurement of lease liability;
- Any initial direct costs;
- Any costs to be incurred for dismantling or removing the underlying asset or restoring the site at the end of the lease term.

The liability for the lease obligation would be measured as the present value of future lease payments including payments that would be made towards any residual value guarantee, discounted using the rate implicit in the lease or the incremental rate of borrowing of the lessor, whichever is available.

The fact that there is no 'invoice' evidencing transfer of the asset cannot be a reason to avoid recognition of the right-of-use asset. In fact, what is being recognised is not an asset, since ownership rights are not transferred. What is sought to be recognised under Ind AS 116 is the right to use the asset in the manner required by the lessee WDG Ltd. Further, since the lease represents an obligation to pay lease rentals in the future, a corresponding lease liability should be recognised. Not recognising the right-of-use asset or lease liability would not only be a violation of Ind AS 116, Leases, but would also be an incorrect presentation of the financial position, which is critical given that WDG Ltd. is interested in taking a loan for its operations.

Ethical issues:

The managing director's threat to the financial manager results in an ethical dilemma for the financial manager. This pressure is greater because the financial manager is new.

Threats to fundamental principles

The fact that the position of the financial manager has been threatened if the treatment suggested by the managing director is not followed indicates that there is an intimidation threat to the fundamental principles of objectivity and integrity. Further, as the manging director has flagged the risk that the company may not obtain loan financing if the lease obligation is recorded in the balance sheet, there is an advocacy threat because the financial manager may be compelled to follow an incorrect treatment to maximise the chances of obtaining the loan. This pressure again is greater because the financial manager is new.

Professional competence

When preparing the financial statements, the financial manager should ensure that the fundamental principle of professional competence should be followed, which requires that accounts should be prepared in compliance with Ind AS. Thus, since the arrangement meets the Ind AS 116 criteria for a lease, the right-of-use asset and a corresponding lease liability should be recognised, as otherwise the liabilities of WDG Ltd. would be understated. The ICAI Code of Ethics and Conduct sets boundaries beyond which accountants should not act. If the managing director refuses application of Ind AS 116, Leases, the financial manager should disclose this to the appropriate internal governance authority, and thus feel confident that his actions were ethical.

If the financial manager were to bend under pressure and accept the managing director's proposed treatment, this would contravene Ind AS 116 and breach the fundamental principle of professional competence. In such a case, he would be subject to professional misconduct under Clause 1 of Part II of Second Schedule of the Chartered Accountants Act, 1949, which states that a member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he contravenes any of the provisions of this Act or the regulations made thereunder or any guidelines issued by the Council. As per the Guidelines issued by the Council, a member of the Institute who is an employee shall exercise due diligence and shall not be grossly negligent in the conduct of his duties.

7. Computation of deduction available to Ms. Tina for A.Y.2024-25

Particulars	**₹**
Life Insurance Premium (See Note 1)	20,000
Contribution to Public Provident fund (See Note 2)	Nil

Tuition fee of 2 sons for graduation course (See Note 3)	16,000
Housing loan principal repayment (See Notes 4 & 5)	Nil
Post Office Time Deposit Scheme (See Note 6)	60,000
Investment in National Savings Certificate (See Note 6)	60,000
Total Investment/contribution	**1,56,000**
Deduction under section 80C restricted to	**1,50,000**

Notes:

1. Any amount of life insurance premium paid in excess of the specified percentage of actual capital sum assured shall be ignored for the purpose of deduction under section 80C. In the given case, since the insurance policy has been issued before 1.04.2012, therefore, premium paid upto 20% of actual capital sum assured i.e., ₹ 56,000 shall be allowed as deduction. Hence, the premium of ₹ 20,000 paid during the year is allowable as deduction under section 80C.

2. In the case of an individual, contribution to PPF can be made in his name or in the name of his spouse or children to qualify for deduction under section 80C. As the contribution was made in the name of his father, deduction is not allowable.

3. Tuition fee paid is eligible for deduction under section 80C for a maximum of two children. Therefore, ₹ 16,000 shall be allowed as deduction. Tuition fee paid to an educational institution situated outside India is not eligible for deduction.

4. In order to claim the principal repayment on loan borrowed for house property as deduction, the construction of such property should have been completed and should be chargeable to tax under the head "Income from house property". In the given case, since the property is under construction, principal repayment does not qualify for deduction.

5. Repayment of principal on housing loan is not allowed as deduction in case the loan is borrowed from friends, relatives etc. In order to qualify for deduction, the loan should have been obtained from Central Government / State Government / bank / specified employer / institution.

6. The following investments are also eligible for deduction under section 80C:-

   (1) five year time deposit in an account under Post Office Time Deposit Rules, 1981; and

   (2) investment in National Savings Certificate

8. I Culture, beliefs, and assumptions of the organisation :

The culture of WDG Ltd. emphasizes quality and customer satisfaction, as evidenced by their commitment to stringent quality control measures and a customer-centric approach. This culture shapes their strategic decisions and influences their competitive positioning within the industry.

II. Stakeholders' influence and expectations :

- The stakeholders of WDG Ltd., including customers, suppliers, employees, and shareholders, have expectations regarding the company's performance, quality, and financial stability. Understanding and managing these expectations is crucial for maintaining stakeholder satisfaction and securing long-term relationships.

III. Strategic capabilities in terms of resources core competences :

- WDG Ltd. possesses state-of-the-art manufacturing facilities, advanced technology, and a wide inventory of spare parts. These resources and core competencies enable the company to produce high-quality industrial spare parts efficiently, contributing to its competitive advantage and strategic positioning within the market.

IV. The macro environment (beyond the control of organisation), especially the basis of competition, industry profitability, industry key success factors, customers' behaviour, markets and regulations, etc., shall be analysed to assess Opportunities and Threats to appraise the strategic position.

Opportunities need to be exploited, whereas a defence mechanism shall be created against threats that can be mitigated. WDG Ltd. operates in a competitive market environment, catering to diverse clientele across multiple industries. Understanding market trends, competitor activities, and regulatory requirements is essential for adapting strategies, identifying opportunities, and mitigating risks to maintain a competitive edge and strategic positioning.

In conclusion, a strategic position analysis is integral to understanding WDG Ltd.'s competitive positioning within the industrial spare parts industry. By examining its internal capabilities, stakeholder influences, task environment, and broader market dynamics, the company can make informed decisions to maintain its competitive edge and drive future success.

CASE STUDY 31

FST Limited is engaged in the business of manufacturing and export of ready-made garments like T-shirts, skirts, tops and similar casual wear. CA T is statutory auditor of the company and also provides tax consultancy services. He also handles matters pertaining to direct and indirect taxes of the company. On a Monday morning, he had gone to the company's office located in NOIDA for participating in a pre-arranged meeting with certain key directors of the company on some matters. The said location also houses company's manufacturing facilities.

Barely had the meeting started, a team of three officers from Income Tax department descended upon the company's premises to conduct TDS survey under Income-tax Act, 1961. After completing the necessary formalities, they asked for financial statements for last three years and evidence of TDS returns filed during those periods. Thereafter, they took control of the systems of the company containing its books of accounts. Meanwhile, directors of the company requested CA T to stay there and help them out in this situation.

After perusing company's accounts books, documentary evidence including bills for few hours, the team summarized following points/ purported lapses by the company in the matter of TDS deduction and incidental issues: -

(i) It was pointed out that company has made payments during these years to Bharat Container Corporation Limited (BCCL), a government owned PSU. The said company operates container cargo services and its terminal is linked with rail lines to various gateway ports including one at JNPT, Nhava Sheva, Mumbai.

FST Limited sends its export bound cargo utilizing above PSU's services. On going through bills raised by BCCL on FST Limited, it was observed that these pertained to charges levied by BCCL for handling containers, road transportation charges and railway freight. The team has pointed out that tax has been short-deducted for above payments made to BCCL.

(ii) FST Limited has made payments during these years to certain companies providing clearing and forwarding services for carriage of goods. The team has pointed out that tax has been deducted on these payments at inappropriate rates leading to short-deduction of tax. The team insists that these payments are in the nature of brokerage and warrant tax deduction rate of 5%.

(iii) FST Limited had also recently participated in a fair in Mumbai in 2023-24 and had paid charges of ₹ 5.00 lakhs towards makeshift stall and use of furniture in an exhibition centre owned by a company. The team had pointed out non-deduction of tax at source by FST Limited on the same.

(iv) During the survey, team also stumbled upon service bills of few clearing and forwarding agents. These agents were acting as shipping agents of non-resident ship owners. FST Limited had paid ocean freight to these shipping agents of non-resident shipping lines. The team had pointed out that tax has not been deducted on ocean freight paid to these shipping agents.

Before leaving, the team raised show-cause notice (SCN) relating to above issues.

Just when he was working on preparing a reply to above SCN after few days in his office, CA T received copy of a notice forwarded by the company. The said notice issued by Superintendent (Anti-Evasion), CGST Division informed that exporter company has been flagged as a "risky exporter" on the basis of risk analysis by DGARM (Directorate General of Analytics & Risk Management). The said notice contained a long list of documents to be submitted by the company including copies of GSTR-9, GSTR-3B, GSTR-1, reconciliations with ITC reflecting on portal, reconciliation of e-way bills issued with GSTR-1, financial statements of past years. The company is exporting goods on payment of IGST. Its export bound shipments attract GST @ 5%. Subsequently, a departmental team also visited premises of the company.

On going through documents submitted by the company and after conducting necessary verifications, team raised the following issues: -

(A) The team pointed out that fabric which is main raw material for manufacturing of garments having taxable value of ₹ 50 lakh attracting GST rate of 5% was destroyed in a fire in premises of the company during month of April, 2023. The company had availed ITC of ₹ 2.50 lakh in the month of April, 2023.

(B) The company has been availing services of a security service agency for providing it with security manpower. The company has paid amount of ₹ 10 lakh to one such security service agency (a proprietorship concern) during year 2023-24 up to date of team's visit. It is insisted that company was required to pay GST on such services under reverse charge mechanism.

(C) It has been pointed out that company has received duty credit scrips under Foreign trade policy of the government by virtue of being in export trade. These duty credit

scrips, in turn, have been sold by the company to third parties. Supply of such duty credit scrips are exempt from GST under *Notification No.35/2017-Central tax (Rate). dated 13.10.2017*. The team points out that company is required to reverse ITC on common input services relating to such exempt supplies.

Assume that Income Tax Law for financial year 2023-24 (A.Y. 2024-25) is applicable in situations involving past years. Ignore surcharges.

I. Multiple Choice Questions

1. Considering matter stated at [i] relating to short-deduction of tax from payments made to BCCL by survey team in their show-cause notice, which of the following statements is most appropriate in this regard?

   (a) Tax was required to be deducted on handling charges and railway freight. However, no tax was required to be deducted on road transportation charges under relevant provisions of law.

   (b) Tax was required to be deducted on road transportation charges and railway freight. However, no tax was required to be deducted on handling charges under relevant provisions of law.

   (c) Tax was required to be deducted on handling charges, road transportation charges and railway freight. The issue raised in SCN is correct and company has short deducted tax from payments made to BCCL.

   (d) Tax was required to be deducted on handling charges and road transportation charges. However, no tax was required to be deducted on railway freight under relevant provisions of law.

2. The survey team has raised the issue of application of inappropriate rate while deducting tax from payments made to certain companies providing clearing and forwarding services at JNPT, Nhava Sheva, Mumbai. Which of following statements is likely to be correct in this regard?

   (a) Tax was required to be deducted @ 5%. FST Limited has deducted tax from payments made to companies providing clearing and forwarding services @ 1%. Hence, there is short deduction of tax @ 4% from payments made to these companies.

   (b) Tax was required to be deducted @ 5%. FST Limited has deducted tax from payments made to companies providing clearing and forwarding services @ 2%.

Hence, there is short deduction of tax @ 3% from payments made to these companies.

(c) Tax was required to be deducted @ 2% and not @ 5% as pointed out by team. The issue raised in SCN is not in accordance with law.

(d) Tax was required to be deducted @ 5%. FST Limited has deducted tax from payments made to companies providing clearing and forwarding services @ 0.5%. Hence, there is short deduction of tax @ 4.5% from payments made to these companies.

3. It was pointed out in the SCN that FST Limited has failed to deduct tax at source on payment made to a company owning exhibition centre in Mumbai for a makeshift stall and use of furniture. Which of following statements is in accordance with law in this regard?

(a) Tax was required to be deducted at source on payment made to the company owning exhibition centre. Such type of payment necessitates deduction of tax at source @ 2%.

(b) Tax was required to be deducted at source on payment made to the company owning exhibition centre. Such type of payment necessitates deduction of tax at source @ 10%.

(c) Tax was required to be deducted only for charges for use of makeshift stall @ 2% and for use of furniture @ 10%.

(d) Tax was not required to be deducted on the type of payment discussed above. Therefore, issued raised in SCN is not in accordance with law.

4. As regards destruction of stock of raw material in a fire in the month of April 2023 is concerned, which statement is most appropriate?

(a) ITC of ₹ 2.50 lakh to be reversed by the company

(b) Output liability by ₹ 2.50 lakh to be reduced by the company

(c) Output liability by ₹ 2.50 lakh to be increased by the company

(d) No treatment is required to be done.

5. The team has raised the issue of non-payment of GST on availing services of a security agency. Which of the following statements is true in this regard?

   (a) GST was required to be paid under forward charge and ITC of ₹ 0.50 lac was required to be taken by the company in its monthly GSTR-3B.

   (b) GST was required to be paid under reverse charge and ITC of ₹ 1.80 lac was required to be taken by the company in its monthly GSTR-3B.

   (c) GST was required to be paid under forward charge but no credit of the same was required to be taken by the company in its monthly GSTR-3B.

   (d) GST was required to be paid under reverse charge but no credit of the same was required to be taken by the company in its monthly GSTR-3B.

II. Descriptive Questions

6. The survey team has raised the matter regarding non-deduction of tax at source on ocean freight paid to shipping agents of non-resident foreign shipping companies in its show-cause notice. How can CA T defend the company while preparing reply to show cause notice as far as this issue is concerned? Quote relevant provisions of law (including notifications/circulars) on this subject matter.

7. The GST team has pointed out that the company is required to reverse the ITC on common input services relating to exempt supplies of duty credit scrips. What is your opinion on this issue considering relevant provisions of law?

ANSWERS TO THE CASE STUDY 31

I. Answers to the Multiple Choice Questions

1. (d) Tax was required to be deducted on handling charges and road transportation charges. However, no tax was required to be deducted on railway freight under relevant provisions of law.

Reason: Under provisions of section 194C of Income-tax Act, 1961, tax is required to be deducted at source in accordance with provisions of this section for carrying out any work. *Explanation* to section 194C explains that work shall include carriage of goods or passengers by any mode of transport other than by railways. Therefore, transport charges by railways does not require deduction of

tax at source. Handling charges are in nature of service contracts and require deduction of tax at source under section 194C.

2. (c) Tax was required to be deducted @ 2% and not @ 5% as pointed out by team. The issue raised in SCN is not in accordance with law.

Reason: The team has pointed out that tax has been deducted on payments made to certain companies providing clearing and forwarding services at inappropriate rates leading to short-deduction of tax. The team insists that these payments are in nature of brokerage and warrant tax deduction rate of 5%. However, team's view point is not in accordance with law. The expenses incurred are not in nature of brokerage. *Explanation* to section 194H provides that "commission or brokerage" includes any payment received or receivable, directly or indirectly, by a person acting on behalf of another person for services rendered (not being professional services) or for any services in the course of buying or selling of goods or in relation to any transaction relating to any asset, valuable article or thing, not being securities.

However, in the given situation, services are being rendered by companies as forwarders and for facilitating their movement and carriage from port to the country of destination. Brokerage is normally associated with payment in nature of buying or selling of goods or in relation to any transaction relating to any asset. Further, circular no.715 dated 8.8.1995 issued by CBDT states that "*as regards payment to clearing and forwarding agent for carriage of goods, the same shall be subject to tax deduction at source under section 194C of Income-tax Act, 1961".*

3. (b) Tax was required to be deducted at source on payment made to the company owning exhibition centre. Such type of payment necessitates deduction of tax at source @ 10%.

Reason: Under provisions of section 194-I of Income-tax Act, 1961, any person, not being an individual or a Hindu undivided family, who is responsible for paying to a resident any income by way of rent, shall, at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon at the rate of—

(i) two per cent for the use of any machinery or plant or equipment; and

(ii) ten per cent for the use of any land or building (including factory building) or land appurtenant to a building (including factory building) or furniture or fittings

Provided that no deduction shall be made under this section where the amount of such income or, as the case may be, the aggregate of the amounts of such income credited or paid or likely to be credited or paid during the financial year by the aforesaid person to the account of, or to, the payee, does not exceed two hundred and forty thousand rupees.

The company has made payment of ₹ 5.00 lakhs for use of building and furniture which is more than threshold limit of section 194-I. It attracts TDS @ 10% as provided for under section 194-I.

4. **(a)** Reversal of ITC of ₹ 2.50 lakh by the company

Reason: Section 17(5)(h) of the CGST Act, 2017 states that input tax credit shall not be available in respect of goods lost, stolen, destroyed, written off or disposed of by way of gift or free samples. Since raw material having taxable value of ₹ 50 lakh has been destroyed in fire, ITC on same amounting to ₹ 2.50 lakh needs to be reversed by the company.

5. **(b)** GST of ₹ 0.50 lac was required to be paid under reverse charge but no credit of the same was required to be taken by the company in its monthly GSTR-3B.

Reason: Security services provided by a person other than a body corporate to a registered person located in taxable territory are liable to GST under reverse charge mechanism. Since FST Limited has availed services provided by way of supply of security personnel from a proprietary firm, it has to pay GST under reverse charge mechanism.

Further, ITC is available in respect of services used in the course or furtherance of business.

II. Answers to the Descriptive Questions

6. In the given situation, FST Limited has made payment of ocean freight to agents of non-resident foreign shipping companies.

Section 194C states that any person responsible for paying any sum to any resident for carrying out any work (including supply of labour for carrying out any work) in pursuance of a contract between the contractor and a specified person shall, at the

time of credit of such sum to the account of the contractor or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, deduct tax at source at specified rates. In accordance with provisions of section 194C, work also includes carriage of goods and passengers by any mode of transport other than railways.

However, Board has issued circular no.723 dated 19.9.1995 in this regard relating to shipping business of non-residents. It states that section 172 deals with shipping business of non-residents. Section 172(1) provides that the mode of the levy and recovery of tax in the case of any ship, belonging to or chartered by a non-resident, which carries passengers, livestock, mail or goods shipped at a port in India. An analysis of the provisions of section 172 would show that these provisions have to be applied to every journey a ship, belonging to or chartered by a non-resident, undertakes from any port in India. Section 172 is a self-contained code for the levy and recovery of the tax, ship-wise, and journey wise, and requires the filing of the return within a maximum time of thirty days from the date of departure of the ship.

The provisions of section 172 are to apply, notwithstanding anything contained in other provisions of the Act. Therefore, in such cases, the provisions of sections 194C and 195 relating to tax deduction at source are not applicable. The recovery of tax is to be regulated, for a voyage undertaken from any port in India by a ship under the provisions of section 172.

Section 194C deals with work contracts including carriage of goods and passengers by any mode of transport other than railways. This section applies to payments made by a person to any "resident" (termed as contractor). It is clear from the section that the area of operation of TDS is confined to payments made to any "resident". On the other hand, section 172 operates in the area of computation of profits from shipping business of non-residents. Thus, there is no overlapping in the areas of operation of these sections.

It further states that there would, however, be cases where payments are made to shipping agents of non-resident ship-owners or charterers for carriage of passengers etc., shipped at a port in India. Since, the agent acts on behalf of the non-resident ship-owner or charterer, he steps into the shoes of the principal. Accordingly, provisions of section 172 shall apply and those of sections 194C and 195 will not apply.

Therefore, it is very much clear from above analysis that FST Limited was not required to deduct tax at source from payments on account of ocean freight to shipping agents

of non-resident ship owners. CA T can defend the company by preparing reply to SCN on these lines.

7. Section 17(2) of the CGST Act, 2017 states that where the goods or services or both are used by the registered person partly for effecting taxable supplies including zero-rated supplies under this Act or under the Integrated Goods and Services Tax Act and partly for effecting exempt supplies under the said Acts, the amount of credit shall be restricted to so much of the input tax as is attributable to the said taxable supplies including zero-rated supplies.

Further, section 17 (3) of the CGST Act, 2017 states that the value of exempt supply under sub-section (2) shall be such as may be prescribed, and shall include supplies on which the recipient is liable to pay tax on reverse charge basis, transactions in securities, sale of land and, subject to clause (b) of paragraph 5 of Schedule II, sale of building.

[**Explanation.**- For the purposes of this sub-section, the expression "value of exempt supply" shall not include the value of activities or transactions specified in Schedule III, except those specified in paragraph 5 of the said Schedule]

In this regard, Rule 42 of the CGST Rules, 2017 prescribes manner of determination of input tax credit in respect of inputs and input services and reversal thereof where input or input services have been partly used for effecting taxable supplies including zero rated supplies and partly for effecting exempt supplies.

Further, Rule 43(1) of the CGST Rules, 2017 prescribes manner of determination of input tax credit in respect of capital goods and reversal thereof in certain cases including where such ITC is partly used for effecting taxable supplies including zero rated supplies and partly for effecting exempt supplies.

Explanation 1 under this clause states that for the purposes of rule 42 and rule 43 of the CGST Rules, 2017, aggregate value of exempt supplies shall **exclude:** -

- the value of services by way of accepting deposits, extending loans or advances in so far as the consideration is represented by way of interest or discount, except in case of a banking company or a financial institution including a non-banking financial company, engaged in supplying services by way of accepting deposits, extending loans or advances and
- the value of supply of Duty Credit Scrips as specified.

Therefore, value of supply of duty credit scrips is excluded from aggregate value of exempt supplies determined under rule 42 of the CGST Rules, 2017. Since value of such supply is excluded while determining value of exempt supplies under rule 42 of the CGST Rules, 2017, no ITC is required to be reversed in respect of such exempt supply.

CASE STUDY 32

Mr. Murli Lal & Mrs. Bansuri Devi have been residing in Manpur village since their marriage. They have been actively involved in agriculture & dairy farming business in their village and sell their output in nearby villages as well. They have earned much accolades for business they run and have accrued much wealth. There have been many instances where the couple felt that they could move to a metro town to explore more but without any knowledge of business world and regulatory compliances, they felt handicapped. Their children are also settled abroad. One fine day, when they are visited by CA Puru, a fast friend of their son who usually comes down to their village quite often to know about the well- being of his friend's parents from time to time. Mrs. Bansuri Devi discusses with him about agricultural operations she manages with the help of her team in the village and scale of operations they maintain. Puru tells them about how agricultural activities are maintained and operated in the metro towns like Mumbai where he lives and practices his profession. During discussion, he tells her that one of his clients, M/s Khetibaadi Ltd., a listed company is involved in agricultural and allied operations by procuring material from nearby areas. This company is also involved in various other types of animal husbandry operations and works on the same scale as Mrs. Bansuri Devi & Mr. Murli Lal work in the village. On getting curious, Mrs. Bansuri Devi asks him about the form and style in which Khetibaadi Ltd. works in the city. Puru tells her that unlike villages, in corporate world, large businesses have to follow certain accounting standards while maintaining books and balances of their businesses. Standards related to agriculture set out accounting for agricultural activity, the management of the transformation of biological assets (living plants and animals) into agricultural produce (harvested product of the entity's biological assets). The standards generally require biological assets to be measured at fair value less costs to sell. He tells her about following activities carried out by Khetibaadi Ltd.:-

- Managing animal-related recreational activities like Zoo
- Fishing in the ocean
- Fish farming
- Development of living organisms such as cells, bacteria and viruses for research
- Growing of plants to be used in the production of drugs.

Hearing about this, Mrs. Bansuri Devi persuades Mr. Murli Lal to set up a company in town

under Puru's guidance to expand their business outside village as well. CA Puru assures Mr. Murli Lal on all his queries and tells him that he and his team will help them at every step in setting up their company. Soon, the couple, with the help of CA Puru, set up and start operating their company in Mumbai under the name & style of M/s. Bansuri Pvt. Ltd. which ventured into business of agricultural operations with Mr. Murli Lal, Mrs. Bansuri Devi and Mr. Prabhudeva as the directors of company. Mr. Prabhudeva is appointed as the managing director, as the former directors are quite busy in the business already set up at Manpur. The company got registered under GST solely in the State of the Maharashtra. During the year, the company falls short of funds and they decide to borrow funds from the market. The Board of Directors of the company resolve to borrow a sum of ₹ 20 crores from a nationalized bank at a Board meeting held on 15.1.2024. Mr. Prabhudeva, who opposes the said borrowing as not in the interest of the company has raised an issue that the said borrowing is outside the borrowing powers of the Board putting forward the following data :-

(i) Share Capital ₹ 5 crores

(ii) Reserves and Surplus ₹ 5 crores

(iii) Secured Loans ₹ 10 crores

(iv) Unsecured Loans ₹ 5 crores.

After the meeting, since Mr. Murli Lal was in Mumbai, he wanted to discuss all the tax matters with CA Puru and sits with him in his office for the same :-

1. With business expansion, Mr. Murli Lal has also purchased a controlling stake in M/s Khetibaadi Ltd. and is now a director in the said company. He wants Puru to tell him briefly about the performance of this company in tea Market as well. Puru tells him that for the previous year ended 31.03.2023, Khetibaadi Ltd.'s composite business profits before allowing deduction relating to growing and manufacturing of tea is ` 50,00,000. On 01.09.2023, it deposited a sum of ₹ 10,00,000 in the Tea Development Account. During the previous year 2021-22, this company had incurred a business loss of ₹ 15,00,000 which has been carried forward. On 25.01.2024, it withdrew ₹ 10 lakhs, from deposit account which is utilized as :-

   (1) ₹ 6,00,000 for purchase on non-depreciable asset as per the scheme specified.

   (2) ₹ 3,00,000 for purchase of machinery to be installed in the office premises;

   (3) ₹ 1,00,000 was spent for the purpose of scheme on 05.04.2024.

Mr. Murli Lal wants to know about the income of the company for the year & the tax liabilities, if any, thereon, and about which CA Puru gives him an approximate idea of at that time itself.

2. Mr. Prabhudeva had informed CA Puru about two peculiar transactions related to GST which he wanted to discuss in the presence of Mr. Murli Lal, related to M/s Bansuri Pvt. Ltd. In one of the cases, they send raw tea leaves to their registered job worker under GST, Mr. Sharma in Mangalore, Karnataka and further, the processed flavored tea, which is further delivered to the wholesalers in Telangana from the job worker's place in Mangalore itself with invoice and the e-way bill being issued by the company's department from the Mumbai office. Further, he asks him about the treatment of another transaction. They had sent a special lot of Tea "Rosa" to another job worker, Mr. Shakti Puri, in Ratlam for making flavoured tea as per the directions given. Further, due to a decline in the market of flavoured tea, they sent fresh normal unprocessed raw tea with new instructions to the job worker to hold the earlier consignment in stock till a buyer is found. The new stock is easily sold, but the old stock remained in godown of the job worker for over a year. CA Puru guides them properly about the tax treatment of these two transactions under GST.

3. Mr. Murli Lal is happy that their business has gone online as well and now they are selling their products through various e-commerce platforms. Mr. Prabhudeva shows his concern over the online selling part and wants CA Puru to keep a check on the working of the same during his audit. CA Puru assures him that his audit strategy would majorly be based on the fact that a good part of the company's business has gone online.

In evening, Mr. Murli Lal takes Puru with him to meet his old friend Mr. Babu Lal who resides in Mumbai with his family. Mr. Babulal had requested him for a meeting with Puru so that he could discuss with the latter certain tax related issues of his family and hire his services for tax related work. Mr. Babulal tells Puru that his son Gautam is liable to pay ₹ 10,000 per month to Barkha (his ex-wife) as alimony. Gautam, being an employee of PQR Pvt. Ltd., has instructed his company's HR department to pay ₹ 10,000 per month out of his salary to his wife directly and remit the remaining salary in his account. Mr. Babulal wants to know the tax treatment of such alimony given by Gautam in his hands. Further, he tells CA Puru that he works under a partnership firm in which he and his other two sons, Mr. B & Mr. C are partners. The partnership deed provides that after his death, Mr. B & Mr. C shall continue the business of the firm

subject to a condition that 20% of profit of the firm shall be given to Mrs. Daya (wife of Mr. Babu Lal). Mr. Babu Lal wants to know the tax treatment of such receipt in his wife's hands after his death. Puru satisfies Mr. Babu Lal by solving all his queries and quotes his fees to handle all the tax related matters of the family.

I. Multiple Choice Questions

1. An assessee carrying on business of growing and manufacturing tea is allowed a deduction under income tax law upon fulfilment of certain conditions like depositing amount in a deposit account opened in accordance with scheme framed by Tea Board. Deposits made in accordance with schemes framed by other Boards for agricultural commodities also qualify for similar deduction. Which of following schemes qualify in this regard?

   (a) Schemes framed by Coffee Board and Spices Board

   (b) Schemes framed by Rubber Board and Spices Board

   (c) Schemes framed by Coffee Board and Rubber Board

   (d) Schemes framed by Coffee Board, Rubber Board and Spices Board

2. Select the correct option on the basis of the following two statements :-

   STATEMENT 1:- Payment of 20% profit to Mrs. Daya is applicaton of income.

   STATEMENT 2:- Payment of alimony by Gautam to his ex-wife is diversion of Income.

   (a) Statement 1 is Correct but Statement 2 is Incorrect.

   (b) Statement 1 is Incorrect but Statement 2 is Correct.

   (c) Both the Statements are Correct.

   (d) Both the Statements are Incorrect.

3. What would be the GST Treatment of the stock lying with Mr. Shakti Puri?

   (a) Tax payable by Mr. Shakti Puri.

   (b) Tax payable by Bansuri Pvt. Ltd on expiry of 1 year from the date of sending of unprocessed tea to job worker.

   (c) No GST liability.

(d) Tax payable by Bansuri Pvt. Ltd. on its removal from the premises of Mr. Shakti Puri.

4. Bansuri Pvt. Ltd. is also engaged in sending raw tea leaves to job workers and selling processed tea after the job work is performed. Which of the following forms/returns is to be filed by Bansuri Pvt Ltd on GST portal in this respect :

(a) ITC-04

(b) ITC-03

(c) ITC-02

(d) ITC-01

5. W.r.t the decision taken at the 4th Board meeting, the contention of director Prabhudeva is -

(a) Valid, as per the provisions of the Companies Act, 2013.

(b) Invalid, as Bansuri Pvt Ltd is a Private Company.

(c) Valid, subject to passing an Ordinary Resolution in the General Meeting.

(d) Valid, subject to passing a Special Resolution in the General Meeting.

II. Descriptive Questions

6. Analyse whether the activities as narrated by CA Puru to Mrs. Bansuri Devi w.r.t Khetibaadi Ltd. fall within the scope of Ind AS 41 with proper reasoning.

7. You are required to state income tax implications of withdrawals from deposit account during financial year 2023-24 relevant for assessment year 2024-25.

8. What specific factors for online shopping would be considered by CA Puru in formulating the audit strategy of the company in the above case keeping in mind the concern raised by Mr. Prabhudeva?

ANSWERS TO THE CASE STUDY 32

I. Answers to the Multiple Choice Questions

1. (c) Schemes framed by Coffee Board and Rubber Board enjoy similar deduction under section 33AB of Income-tax Act, 1961.

2. (d) Both the Statements are Incorrect.

Reason: STATEMENT 1 :- Such income does not reach the assessee-firm. Rather, such income stands diverted to the other person as such other person has a better title on such income than the title of the assessee. The firm might have received the said amount, but it so received for and on behalf of Mrs. Dayaa, who possesses the overriding title. Therefore, the amount payable to Mrs. Daya after the death of Mr. Babu Lal would be excluded from the income of the partnership firm in question.

STATEMENT 2 :- In this case, the amount of ₹ 10,000 per month is an obligation of Gautam to pay to his ex-wife out of his income and not an income in which she had over riding entitlement. In other words, this is the income of Gautam, which is applied by him to fulfill an obligation and hence, includible in his total income and a mere arrangement to pay a sum directly to his ex-wife would not make it a case of diversion of income.

3. (b) Tax payable by Bansuri Pvt. Ltd on expiry of 1 year from the date of sending of unprocessed tea to job worker.

Reason: Here, sending of unprocessed tea by Bansuri Pvt Ltd to the job worker Mr. Shakti Puri in the first lot will be deemed as a supply and thus, tax would be payable on the same by the company.

4. (a) ITC-04.

Reason: ITC-04 is the prescribed return/form under GST Rules for giving account of goods sent on job work and received back.

5. (b) Invalid, as Bansuri Pvt Ltd is a Private Company.

Reason: According to the provisions of Section 180(1)(c) of the Companies Act, 2013, the powers of the Board are not uncontrolled and there are restrictions on the borrowing powers to be exercised by the Board of Directors. According to the said section, the borrowings should not exceed the aggregate of the paid-up share capital, free reserves and securities premium. While calculating the limit, the temporary loans obtained by the company from its bankers in the ordinary course of business will be excluded. However, from the figures available in the present case, the proposed borrowing of ₹ 20 crore will exceed the limit calculated as per the given information. Thus, the proposed borrowings are beyond the powers of the Board of Directors. In view of the above position, the

management of any Company should take steps to pass a special resolution authorising to borrow the proposed amount of ₹ 20.00 crore, so that the requirement of Section 180(1)(c) is satisfied. Only thereafter, the proposed borrowing can be availed of.

However, Bansuri Private Limited is a Private Company and as per the MCA notification dated 5th June, 2015 which stated that this section shall not apply to private companies. Further on 4th January 2017, Specified IFSC public company would also not be required to comply with this section, unless the article of the company provides otherwise. Hence, they can avail the required Borrowing. As notified by the MCA, Section 180 of the Act (i.e. restrictions on the powers of the Board) shall not apply to a private company which has not committed a default in filing is financial statements under Section 137 or Annual Return under Section 92 with the Registrar. [Notification No. 464(E), dated 5thJune, 2015 as amended by Notification No. 583 (E), dated 13th June, 2017.]

II. Answers to the Descriptive Questions

6.

Activity	Whether in the scope of Ind AS 41?	Remarks
Managing animal- related recreational activities like Zoo	No	Since the primary purpose is to show the animals to public for recreational purposes, there is no management of biological transformation but simply control of the number of animals. Hence it will not fall in the purview of the definition of agricultural activity.
Fishing in the ocean	No	Fishing in ocean is harvesting biological assets from unmanaged sources. There is no management of biological transformation since fish grow naturally in the ocean. Hence, it will not fall in the scope of the definition of agricultural activity.

Fish farming	Yes	Managing the growth of fish and then harvest for sale is agricultural activity within the scope of Ind AS 41 since there is management of biological transformation of biological assets for sale or additional biological assets.
Development of living organisms such as cells, bacteria and viruses for research.	No	The development of living organisms for research purposes does not qualify as agricultural activity, as those organisms are not being developed for sale, or for conversion into agricultural produce or into additional biological assets. Hence, development of such organisms for the said purposes does not fall under the scope of Ind AS 41.
Growing of plants to be used in the production of drugs	Yes	If an entity grows plants for using it in production of drugs, the activity will be agricultural activity. Hence it will come under the scope of Ind AS 41.

7. Tax consequences for the A.Y. 2024-25

Particulars	(₹)
₹ 10,00,000 being the amount withdrawn from Tea Development Account has to be utilized in the prescribed manner, otherwise, the withdrawn amount would be chargeable to tax as business income. In the given case, the taxability of withdrawal amount based on their utilization is as follows:	Not taxable
- ₹ 6,00,000, out of the amount withdrawn from the deposit account, utilised for purchase of non-depreciable asset as per the specified scheme. [As per section 33AB(6), no deduction would be allowed under section 33AB since amount is spent out of ₹ 10 lakh deposited in Tea Development Account, which has already been allowed as deduction in A.Y. 2023-24 **(See Working Note below)**].	
- ₹ 3,00,000, being the amount utilized for purchase of machinery to be installed in the office premises is not a permissible utilization. Hence, the amount would be deemed as profits and gains of business of the previous year 2023-24 as per section 33AB(4).	3,00,000

- ₹ 1,00,000 was spent for the purpose of scheme on 05.04.2024. As per section 33AB(7), this amount would be taxable since the same is not utilized during the same previous year (i.e., P.Y. 2023-24) in which the amount is withdrawn from the deposit account.	1,00,000
When any part of withdrawal amount becomes taxable, the agricultural and non-agricultural portions of income must be segregated. Accordingly, ₹ 1,60,000, being 40% of ₹ 4,00,000 (₹ 3,00,000 + ₹ 1,00,000) would be chargeable to tax as business income and the balance ₹ 2,40,000, being 60% of ₹ 4,00,000 would be agricultural income exempt from tax.	

Working Note:

Computation of Business Income of Khetibaadi Ltd. for the A.Y. 2023-24

Particulars	(₹)
Composite business profits before allowing deduction under section 33AB	50,00,000
Less: Deduction under section 33AB(1) would be the lower of:	
- Amount deposited in Tea Development Account on or before 30.9.2023 [i.e., ₹ 10,00,000]	
- 40% of profits of such business [i.e., ₹ 20,00,000, being 40% of ₹ 50,00,000]	10,00,000
	40,00,000
Less: 60% of ₹ 40,00,000, being agricultural income **[as per Rule 8]**	24,00,000
Business income	16,00,000
Less: Brought forward business loss of A.Y. 2022-23 set-off as per section 72	15,00,000
Business income chargeable to tax	**1,00,000**

8. **Formulation of Audit Strategy:** While formulating the audit strategy for a company, following factors may be considered -

Specific Factors for Online Shopping: The auditor shall also obtain an understanding of the information system including the related business processes due to new venture of online shopping in the following areas:

(i) The classes of transactions in the entity's operations that are significant to the financial statements;

(ii) The procedures, within both information technology (IT) and manual systems, by which those transactions are initiated, recorded, processed, corrected as

necessary, transferred to the general ledger and reported in the financial statements;

(iii) The related accounting records, supporting information and specific accounts in the financial statements that are used to initiate, record, process and report transactions; this includes the correction of incorrect information and how information is transferred to the general ledger. The records may be in either manual or electronic form;

(iv) How the information system captures events and conditions, other than transactions, that are significant to the financial statements;

(v) Controls surrounding journal entries, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments.

CASE STUDY 33

Prime Tea Private Limited (PTPL) was established in 1938, headquartered in Kolkata. The company is privately owned by the Triboovandas family members, who have been in the tea business for the past 3 generations. Mr. Bhushan Triboovandas started out as a broker in the Siliguri Auction Centre. In due course, he started a tea blending and packaging company, PTPL in Kolkata. Tea leaves are blended and packed at its production facilities and sold further to tea distributors. Tea distributors in turn sell the packages to other smaller wholesalers or large retail outlets. Retail chains across India stock tea packages blended by PTPL.

In smaller cities and towns, where there is no presence of proper distributors, PTPL has local sales agents that it hires on contract to sell tea to small grocery stores and other local shops. Goods are sent to these local agents on consignment. Tea packages have a long shelf life and can be stored up to a year if stored in appropriate conditions. PTPL commands a moderate 8% market share in terms of sales in the Indian Market.

PTPL has been a profitable business for most of the years of its existence. The past many years have seen significant inflationary trends in the economy. Like many other companies, PTPL too has been enduring the increase in tea leaf price, which is the primary raw material. To combat reducing profit margins due to inflation, it has concocted a uniform blend that it sells under the brand name “A1 Tea”. The blend is prepared by mixing few popular tea flavours into one. This concoction was done with the help of an expert tea sommelier a decade back. PTPL has used same composition over the last many years. The tea that PTPL prepares under the “A1 Tea” is of the black tea variety, which is the most popular tea variety consumed in India.

The Indian marketplace is crowded with many tea companies like PTPL. In retail outlets and grocery stores shelves stocking tea beverage have many brands stocked together. There is nothing much to differentiate PTPL’s “A1 Tea” brand from the rest. Brands have to fight to gain visibility among customers and this is done using attractive packaging, increasing advertisement spend, etc. Hence, customers are more price sensitive rather than conscious about quality of tea.

Today, in 2023 the total Indian Tea market is estimated to be ₹ 34,400 crore with branded business constituting approximately 74% of the total market value. The global tea market is estimated to be $45-50 billion with the main demand coming from the Black Tea segment. Demand in other segments like Green Tea, Fruit & Herbal, Decaf, Speciality among others is

also picking up. Despite optimistic prospects, the management at PTPL observes stagnation in tea sales rather than growth.

Currently, PTPL supplies tea to 300 distributors across India. An investigation into this revealed that many of the distributors are also distributors for competitors of PTPL. The investigation further revealed that in the past 3 years, many times PTPL has delayed the delivery of orders to these distributors. When distributors run out of "A1 Tea" packages, they place an order with the company for stocking up their inventory. Meanwhile, orders from retail outlets and smaller distributors keep coming in, which need to be met by the distributors on time. Hence, if the packages of "A1 Tea" are not replenished in time, distributors instead sell packages of another rival company to meet the order demand on time. The retail outlets and smaller distributors (who are customers of the distributors) are largely indifferent to which brand of tea. As mentioned in the paragraph above, this is because there is not much to differentiate "A1 Tea" from the rest of the brands of similar variety.

A further investigation for the reason for delays in meeting restocking requests of distributors was undertaken. The delayed sales delivery is costing the company in the form of lost opportunity sales. The study of this problem reveals that PTPL has been following Just in Time (JIT) production in its production facilities. This was implemented around 3 years back by the production manager who had wanted a lean production system. Accordingly, the tea blending process happens only when a distributor places an order for tea packages with PTPL. A typical order size would be 50,000 packages a month from each distributor. In a month at least 200 distributors place orders with PTPL.

The raw material in the form of tea leaves is stocked in advance by buying tea from various auctions. Since "A1 Tea" is a blend of popular tea flavours, it requires a mix of tea leaves providing those different flavours. It was found that these different types of tea leaves had different growing, cultivation cycle and were grown in different plantations spread across India. Hence, while stocking up for raw materials, it does happen many times that a particular type of tea leaf is unavailable at that auction centre. In such cases, the tea leaf has to be sourced from some other auction centre or sometimes directly from the plantation. These delays increase the lead time for procurement for tea leaves. The purchase manager at PTPL has not taken any initiative to resolve the problem and reduce the lead time for procurement. Hence, because the entire raw material of the required varieties of tea leaves are always not readily available, it has many times happened that there have been delays in the production of the blended tea. Since the production is JIT system based, PTPL does not have buffer stock of blended tea (finished product) from which it could try to meet the order requirements at least partially. This is the

primary reason for delays in sales delivery, which has resulted in the distributors preferring to sell rival tea brands.

Mr. Kumar, son of Bhushan Triboovandas is the CEO of PTPL. Last month, he called the senior management of the company to understand the reason for stagnating sales. This month, there was a follow up meeting where the findings of the investigations detailed above, were presented to him. On presentation of the findings, an argument ensued between the sales, production and procurement managers defending their department and function.

Sally, the sales manager: "I am facing the brunt of this problem. It is already very difficult to sell "A1 Tea" as it does not enjoy very high visibility due to which the end user customer is indifferent to the brand and its quality. Distributors also do not get any additional incentive to sell "A1 Tea" since the profit margin they derive is just the same from any other brand. While I am trying my best to promote and sell our tea, I am not given sufficient support by Pam from our production department. Others too need to do their job well in order to sustain sales. Is that not the least I can expect?"

Pam, the production manager: "My hands are tied, we have best in class blending machines that can blend tea in huge quantities on very short notice. The short turnaround time for sales delivery was considered while implementing the JIT production system 3 years back. This is the reason why we had these high-performance machines installed in the first place. I just need a phone call from Sally and my machines are ready to do the job. My department cannot be blamed for delays if the requisite raw materials are not available. Procurement is Sam's responsibility; she should be made accountable for this."

Sam, the procurement manager: "It is unfair to lay the entire blame on me. I have no information about what the production is going to be during the month. I need at least 1-month advance notice if not more, to ensure that raw material supply is uninterrupted. Perhaps my colleagues here have forgotten that tea leaves are agricultural produce that cannot be grown on the drop of a hat. I need time to get the varieties of leaves from different auction locations across India to our storage facility here in our plant. Certain varieties are available only for few seasons, hence procuring them during off seasonal months is very difficult. While JIT production may work fine for blending, JIT procurement is impossible for tea leaves. I need advance notice of raw material requirements. Without this information, I cannot ensure their supply."

Mr. Kumar says "Right from my father's days, all departments had complete understanding of each other's requirements. We have never felt the need to have information systems in place. All that was required was a phone call between the managers for the business to be done. Of-

course, over the years we have grown in scale. However, this has led to gaps in passing on information. How can we resolve this?"

I. Multiple Choice Questions

1. Giving the case study scenario, which pricing strategy do you think that PTPL is following for its "A1 Tea" brand?

   (a) Cost plus markup pricing

   (b) Target rate of return

   (c) Perceived value pricing

   (d) Going rate pricing

2. Below is the cost structure for producing of 1 kg of "A1 Tea":

Direct material cost	₹ 200
Direct labour cost (20 minutes, costing ₹ 300 per hour)	₹ 100
Overhead cost	₹ 50
Total cost	₹ 350

   In addition, 1 kg of "A1 Tea" also requires 0.6 kg of other material which costs ₹ 80 per kg, with 4% substandard quality which cannot be used in production of tea.

   PTPL sells 1 kg of "A1 Tea" for ₹ 400. PTPL wishes to earn 10% profit margin on the same. Is the target cost being met?

   (a) No, the total estimated cost is ₹ 400 per kg while target cost is ₹ 360 per kg.

   (b) Yes, the total estimated cost is ₹ 350 per kg while target cost is ₹ 400 per kg.

   (c) Yes, the total estimated cost is ₹ 350 per kg while target cost is ₹ 360 per kg.

   (d) Yes, the total estimated cost is ₹ 400 per kg while target cost is also ₹ 400 per kg.

3. Rani is a tea sommelier who has recently graduated from university and holds a professional certified tea sommelier degree. Few months back, she started 2 outlets by the name "Queen Tea" in Kolkata which serves gourmet tea specially crafted by her. Business has been profitable and has gained traction in terms of revenue and customers. Rani envisions that she can revolutionize the tea industry by influencing the taste preference of tea consumers.

Her specially crafted tea is authentic, unique in flavour that can be appreciated by real tea enthusiasts. India's economy has space even for niche tea enthusiast who are willing to pay a premium for a good cup of tea beverage. However, Rani is facing many issues running the business-like access to extra finance, networking, how to market her product etc. Whom should she approach to find proper guidance, finance, and support?

(a) An incubator

(b) An accelerator

(c) A start up

(d) An intrapreneur

4. In order to drive up sales, PTPL started offering a teacup free for every 1 kg of "A1 Tea" bought per order. This would be an example of:

(a) Awareness

(b) Promotion

(c) Subscription

(d) Cross subsidization

5. An employee of PTPL visited Guwahati to purchase tea leaves from an auction at Guwahati Tea Auction Centre and had stayed in the hotel located in Guwahati, Assam. At the time of checkout from hotel, the invoice was issued for an amount equivalent to ₹ 1,00,000. The hotel issued invoice in the name of PTPL and GST was charged at the rate of 14% CGST and 14% SGST on total invoice amount of ₹ 1,00,000. Out of such amount, the amount recoverable from the employee towards non-official stay by PTPL was ₹ 50,000.

Whether input tax credit is available on the GST paid by PTPL on the invoice amounting to ₹ 1,00,000 to the hotel located in Guwahati, Assam, for stay of the employee? If yes, please specify the amount of input tax credit available.

(a) Yes, ₹ 14,000 as CGST and ₹ 14,000 as SGST

(b) Yes, ₹ 28,000 as IGST

(c) No input tax credit is available

(d) Yes, ₹ 7,000 as CGST and ₹ 7,000 as SGST

6. PTPL entered into a contract with Nayan Distributors, Siliguri for supply of 1 tonne of "A1 Tea". It sent the said consignment to the distributor and paid loading and unloading charges of ₹ 20,000.

Which of the following statements is correct under the GST law?

(a) "A1 Tea" is an agricultural produce. Loading and unloading of "A1 Tea" is exempt from GST.

(b) "A1 Tea" is an agricultural produce. Loading and unloading of "A1 Tea" is liable to GST.

(c) "A1 Tea" is not an agricultural produce. Loading and unloading of "A1 Tea" is liable to GST.

(d) "A1 Tea" is not an agricultural produce. Loading and unloading of "A1 Tea" is exempt from GST.

7. PTPL recently came across a new export opportunity, involving the export of tea to Country 'N' via the Rupee State Credit Route. However, the person who will execute the trade is based out of Country 'N' and would charge a commission of 20%. The CFO informed the CEO that we cannot enter into this trade as the remittance of commission on the Rupee State Credit Route is not allowed.

Considering the given legal position of the execution of the trade through the payment of commission on export under Rupee State Credit Route, comment on correctness of advice of CFO on such remittance of commission in the light of the Foreign Exchange Management Act, 1999.

(a) Yes, the CFO is correct. No commission can be paid on exports through the Rupee State Credit Route. Hence, we cannot export the tea.

(b) No, the CFO is incorrect. Commission up to 20% can be paid on exports through the Rupee State Credit Route. Hence, we can export the tea and remit the commission to the agent.

(c) No, the CFO is incorrect. Although commission cannot be paid on exports through the Rupee State Credit Route, however commission up to 10% of invoice value of export can be paid on tea and tobacco. Here, still cannot export the tea because commission only up to 10% is allowed.

(d) No, the CFO is incorrect. Although commission cannot be paid on exports through the Rupee State Credit Route, up to 20% commission can be paid on tea and tobacco. Hence, we can export the tea and remit the commission to the agent.

8. The management of PTPL has developed a strong internal control in its accounting system in such a way that the work of one person is reviewed by another. Since no individual employee is allowed to handle a task alone from the beginning to the end, the chances of early detection of frauds and errors are high. To facilitate the accumulation of the information necessary for the proper review and evaluation of internal controls, PTPL's auditor framed an internal control questionnaire to obtain an understanding of internal financial control relevant to the audit in order to design audit procedures that are appropriate. Which of the following questions relates to the procurement of tea leaves.

i. Is there a procedure in place to match received tea leaves with corresponding invoices?

ii. Is there a procedure of monitoring broad customer preferences worldwide?

iii. Are provisions for bad debts made based on a systematic assessment of the collectability of outstanding receivables?

iv. Is there a designated authority responsible for approving tea leaf procurements?

v. Is there a confirmation process, such as signed delivery receipts, to validate successful deliveries?

(a) Only (i)

(b) (i) and (iv)

(c) (i), (ii) and (iv)

(d) (ii), (iii) and (v)

II. Descriptive Questions

9. Anticipating heated arguments, Mr. Kumar on behalf of PTPL, has hired you as a management consultant to guide the company on ways to improve its sales and increase its market share. Your priority is to resolve the issue of delayed sales delivery to the tea distributors. Reduction in instances of lost sales opportunities will dramatically improve the sales for PTPL and grow its market share.

Required

Write a brief note addressed to the senior management, ADVISE critical points that need to be attended to in order to resolve this issue.

10. PTPL extends a "net 30" day credit to its distributors (customers). The 30-day credit period begins from the time of dispatch of goods from PTPL's warehouse. Invoices are generated and posted to the distributors. On an average it takes 3 days after dispatch to generate the invoice and a further 3 days for the post to reach the distributors. So, totally the distributor gets the invoice 6 days after dispatch. There have also been instances of the invoice being misplaced or not being received at all. In such cases, PTPL resends the invoice, which again requires few more days to reach the distributor.

    Only 30% of the accounts receivable is collected within 30 days. On an average, the accounts receivable collection period is 50 days. PTPL does not charge any interest for this delay since it wanted to maintain good relations with the distributors. Bad debts account for almost 10% of the accounts receivable.

    Required

    You have been requested to ADVISE ways to reduce the collection period from the current average of 50 days to 30 days without creating any acrimony with distributors.

11. 'If we recoup the entire accounts receivable, that is there are no bad debts, it also means that we are profitable. It also means that each and every customer contributes towards this profit'. Mr. Kumar

    Required

    Critically ANALYZE this statement and ILLUSTRATE whether it is always true.

ANSWERS TO THE CASE STUDY 33

I. Answers to the Multiple Choice Questions

1. (d) Going rate pricing.

Reason: Going rate pricing is a competition-based pricing where the company sets the price based on the market price for the product. The market is highly competitive. Hence, it is given that customers are more price sensitive and

indifferent between different brands. So, going rate price would be the best pricing for PTPL to follow.

2. (a) No, the total estimated cost is ₹ 400 per kg while target cost is ₹ 360 per kg.

Reason: The total estimated cost is:

Direct material cost	₹ 200
Direct labour cost (20 minutes, costing ₹ 300 per hour)	₹ 100
Overhead cost	₹ 50
Other material (0.6 kg. / 96% × ₹ 80 per kg.)	₹ 50
Total estimated cost (per kg.)	₹ 400

The target cost if the company wishes to earn 10% of revenue as profit is ₹ 360 per kg. Selling price ₹ 400 per kg less profit margin

₹ 40 per kg = ₹ 360 per kg.

3. (b) An accelerator.

Reason: Accelerators can accelerate growth by removing some of the risk and uncertainty involved; through a short-term program usually for start-ups that already have a Market Viable Product (MVP), which in Rani's case is her specially crafted gourmet tea. She can get guidance on how to scale up business, have access to business mentorship and guidance that can improve profitability, get industry connections etc. An accelerator generally gets an equity stake in the startup that joins its program. This gives proper motivation to provide proper guidance to the startup founder.

4. (b) Promotion.

Reason: A low-cost product, teacup in this case, is offered for free in for the purchase of 1 kg of "A1 Tea".

5. (c) No input tax credit is available.

Reason: ITC of GST paid on hotel accommodation is not available as CGST/SGST of one State cannot be utilized for discharging of CGST/SGST liability of another State.

6. (c) "A1 Tea" is not an agricultural produce. Loading and unloading of "A1 Tea" is liable to GST.

Reason: Item (e) of Entry 54 of Notification No. 12/2017 CT(R) dated 28.06.2017 exempts loading, unloading, packing, storage or warehousing of agricultural produce. In this regard, it may be noted that "A1 Tea" is a blended tea prepared by mixing popular tea flavours into one. Different tea flavours are processed products - dried, fermented, and cut tea leaves. Thus, "A1 Tea" is not an "agricultural produce" and thus, loading of the same is not eligible for exemption under entry 54.

7. (c). No, the CFO is incorrect. Although commission cannot be paid on exports through the Rupee State Credit Route, however commission up to 10% of invoice value of export can be paid on tea and tobacco. Here, still cannot export the tea because commission only up to 10% is allowed.

Reason: In accordance with Foreign Exchange Management Act, 1999, Schedule 1, transactions for which drawal of foreign exchange is prohibited includes payment of commission on exports under Rupee State Credit Route, except commission up to 10% of invoice value of exports of tea and tobacco.

8. (b) (i) and (iv).

Reason: In the internal control questionnaire developed by PTPL's auditor, it is noted that question (ii) is primarily focused on study of consumer behaviour or demand pattern rather than directly addressing internal control measures. Meanwhile, question (iii) pertains to internal controls associated with receivables, and question (v) specifically addresses internal control aspects related to the dispatch of tea.

II. Answers to the Descriptive Questions

9. Let me begin with Mr. Kumar's observation that there are no information systems in place despite the company growing in scale over the years. As correctly pointed out, there are gaps in passing on information which has resulted in delays and thereby lost sales opportunities.

JIT production system works will work well only when PTPL can anticipate the demand patterns of distributors for "A1 Tea". It is of paramount importance therefore, that the sales forecast be as accurate as possible. This role will primarily be driven by Sally, the sales manager. She has to study the demand patterns, interact with distributors to understand the market and customer needs. Once, the sales order trend is understood, Sally has to prepare a monthly plan for expected sales. This can be drawn in anticipation

for the entire year. This plan will then give the company an idea about the output required to be produced to meet the distributor's demand in its entirely and on time.

The production manager, Pam has implemented the JIT production system 3 years back. The problem of delays in meeting sales orders also began around that same period. This provides a reasonable ground to conclude that the lost sales opportunities could be linked to the type of production system followed at the production centre. If production has to happen seamlessly, the raw material should be available on demand. Hence, there is a requirement for information to flow from sales to production and to procurement departments. Sally has to share the sales plan with both Pam and Sam, the production and procurement managers respectively. When the expected annual output needed is known, production and purchasing can align their functions accordingly.

Pam, the production manager has to then co-ordinate with Sam the procurement manager and discuss the production schedule. Any specific requirements have to be discussed, for example the requisite grade of tea leaves, any other technical aspect that needs attention. If a JIT production system is to be followed, there may not be much time for quality check of the raw material input or to look into certain technical specifications at the last moment. Any misunderstanding or lack of information will lead to delays in production and the system will not be Just in Time at all.

Coming to raw material procurement, the raw material tea leaves have to be adequately stocked up. Being an agricultural produce, a JIT procurement system may not always be feasible. Moreover, different varieties of tea have to be procured from different auctions in different geographical locations. All this increases the lead time for procurement of tea leaves (the raw material for blended tea). However, the sales, production and purchase manager have to co-ordinate to ensure that there are no delays in availability of raw material for immediate production. Tea leaves are procured at auctions from across India. Sam has to ensure that there is always adequate stock of the required varieties of tea leaves based on the likely production schedule shared by Pam. Sam can even consider the possibility of having buffer stock in order to meet any rush requirements. These off-course would be subject to the available storage space, cost of storage and any resultant loss or waste on storage.

Further the production manager can consider the possibility of "making to stock" instead of using "JIT which is making to order". It is mentioned that packaged tea has a long shelf life, if stored in appropriate conditions. Also, procurement of tea leaves requires lead time and co-ordination between the company and brokers at auctions or sometimes even with

tea plantations when the variety in unavailable. Company can explore the possibility of having long term contracts with brokers or plantations for its tea leaf requirements. Due to long lead times required for procurement, it makes sense to stock up the raw material. At the same time, since the finished product has a long shelf life, it may make sense to stock up the finished product as well. This can give company a buffer to provide for any rush orders from distributors or even provide for errors in its sales forecasting. This can be the support that Sally is looking from both Pam and Sam.

10. TPL is using a manual method for dispatching invoices to its distributors (customers). The distributor is made aware of the amount payable 6 days after dispatch of goods. This is almost 20% of the credit period (6 days out of 30 days). So, the distributor gets 24 days to arrange for the payment on the due date. The following steps can help to improve the collection of accounts receivable on due date and help to reduce bad debts:

(i) Revisit the credit period extended: If only 30% of the accounts receivable is collected within 30 days, it implies that the balance 70% delay the payment / settlement. PTPL has to assess whether the credit period of 30 days is reasonable and in line with industry standards. If the credit period is longer than 30 days, then PTPL may need to at least temporarily adjust to the industry norm for settlement with distributors. If the credit period is 30 days or lesser, then PTPL should develop an understanding with the distributors that emphasises that the payment has to be made within due date of 30 days.

(ii) Better distributor relations: For PTPL to be able to dictate terms to distributors, it must first ensure that the distributor's requirements are met on time. Hence, PTPL has to ensure that it delivers the goods on time, it has the capability of restocking whenever requested by the distributor. The other improvement can be by automating the invoicing, it can be generated and sent electronically as soon as the goods are dispatched to the distributor. This way there is sufficient information about the amount to be settled, giving distributor ample time to arrange for funds.

(iii) Credit analysis of distributors: PTPL has to analyze which distributors cause delay in payments or default in payments. Credit should be extended only to credit worthy distributors.

(iv) Ensure multiple channels of settlement: PTPL should provide various channels through which settlements can be conducted, including electronic transfers, and other banking channels such as cheques or drafts. Electronic mode of settlement ensures that the funds are received instantaneously. At times when the distributor

is constrained by one method, PTPL should be in a position to offer alternate settlement methods.

(v) Offer discounts on early settlements: To encourage early receipt of funds, PTPL can offer a small discount if the funds are remitted before due date. For example, PTPL can offer 1/10 net 30 deal. If a distributor settles the entire amount due within 10 days, a discount of 1% can be availed. Beyond 10 days until 30 days, no discount can be availed but there will be no penalty or interest either. Beyond 30 days, there can be an interest or penalty charged.

11. Recouping entire accounts receivable, with zero bad debts is indeed an ideal situation. Simply put, the company has managed to recover the entire sales that it has made to its distributors. However, it does not imply that the company is profitable. A quick example would be a case where 1 kg. tea package costs ₹ 300 to manufacture while due to intense competition, the company is forced to sell it at ₹ 250. The net loss incurred in this sale is ₹ 50, this would be so despite the entire amount outstanding of ₹ 250 is received. This refutes the first statement that 'If we recoup the entire accounts receivable, that is there are no bad debts, it also means that we are profitable.' The above example shows that this need not always be true.

Coming to the second assertion that 'if the bad debts are nil, it also means that each and every customer contributes towards profitability'. Again, this need not always be true.

Note: Let us take the example below for the purpose of better understanding.

Let us say PTPL has only 2 customers (here distributors). Details of sales and cost of generating these sales are given below –

Particulars	Distributor A (₹)	Distributor B (₹)	Total (₹)
Sales	10,000	30,000	40,000
Less: Cost of Goods Sold	5,000	15,000	20,000
Cost of sales visits (specifically traced to customer based on actual sales visits) A: 1 visit × ₹ 500 per visit B: 10 visits × ₹ 500 per visit	500	5,000	5,500
Sales order processing cost (allocated based on number of orders) A: 1 order × ₹ 500 per order B: 10 orders × ₹ 500 per order	500	5,000	5,500

General administrative cost (based on number of hours of support lent to each customer)	1,000	2,000	3,000
Profitability	3,000	3,000	6,000

From the above example, it can be seen that each distributor contributes the same profit of ₹ 3,000 each to PTPL. However, Distributor A is lot more profitable (profit margin is 30% of sales) as compared to Distributor B (profit margin is 10% of sales). Hence, the profitability of each customer is not the same. It could very well be that there may be loss making customers, the loss is absorbed by the profits generated from other customers. Hence, even if the entire outstanding amount is recouped, it does not mean that each and every customer contributes towards profitability.

The type of detailed customer wise profit analysis done above is called Customer Account Profitability. By attributing revenue and costs to each of the customers, their individual contribution towards the profit margin of the company can be calculated. Costs will vary since the amount of support each customer needs from the company may be different. In the above example, Distributor B needed more sales visits as compared to Distributor A. The number of sales visits were 10 times more, but that yielded revenue only 3 times more than Distributor A. Reasons for this have to be understood. There may be underlying problems with the sales arrangement with the customer or PTPL can perhaps improve some busine

CASE STUDY 34

LWS & Co., a chartered accountant firm has been into practice since 2006 in Delhi. CA Suresh Shah and CA Harvinder Kaur started their firm after practicing individually for almost 4 years and now firm has grown into big firm of 5 partners. The partners of firm have contributed various articles on subjects of Direct tax and allied Laws in professional journals and magazines. The clientele encompasses various segments i.e. software, education, NGOs, Government Bodies, real estate, construction, jewellery and a host of others. Over the years, the firm has evolved into renowned professional firm that has worked on various assignments ranging from statutory audits, management audits, income tax planning, FEMA consultancy, GST consultancy, establishment of overseas ventures and other related matters.

The firm has unique way of training its articles by involving them with its experienced partners on crucial projects so that they are able to learn and understand the practical issues arising in different industries. Currently, Subhash, Ashish and Manoj being articles of the firm are working with CA Harsh Bhatia, CA Nikhil Grover and CA Sakshi Ahuja, respectively for prestigious clients of the firm.

(1) Subhash assisting CA Harsh Bhatia

Currently, CA Harsh Bhatia is working on the applicability of Ind AS for various clients. The firm has a prestigious client, Shivalik Construction Private Limited, a construction company. On 1st January 2024, the company contracts to renovate a building including installation of new elevators. The company estimates following with respect to the contract:

Particulars			**Amount (₹)**
Transaction price			60,00,000
Expected costs:			
(a)	Elevators	10,00,000	
(b)	Other costs	35,00,000	45,00,000

The company purchased elevators and they are delivered to the site six months before they will be installed. The Company uses an input method based on cost to measure progress towards completion. The Company has incurred actual other costs of ₹ 7,00,000 by 31st March, 2024. The accounts team of the Company is facing difficulty in recognising revenue in respect of above contract. So, they have approached CA Harsh Bhatia with the

abovementioned facts. CA Harsh Bhatia delegated the said work to Subhash to start initial working and then revert to him with his opinion.

(2) Ashish assisting CA Nikhil Grover

CA Nikhil Grover handles tax department of the firm. The final calculation of income tax and tax planning is being headed by CA Nikhil Grover. He is nowadays being assisted by Ashish. One of the oldest clients of the firm is MVS Private Ltd. The accountant of the company approached CA Nikhil Grover for calculation of final tax liability of the company. CA Nikhil assigned the work to Ashish. The accountant showed financials of the company to Ashish as below:-

The Profit & Loss Account of MVS private Limited for the year ended 31st March, 2024 shows a profit of ₹ 75 lakhs after debiting the following items:

(i) ₹ 2 Lakhs contributed to Employee's Welfare Trust (not required as per any law for the time being in force).

(ii) ₹ 7,80,000 paid towards course fee and hostel expenses for MBA course of a close relative of a director. The relative is not in employment with the company.

(iii) ₹ 3.50 lakhs being expenses incurred on installation of a traffic signal, so as to facilitate its employees coming to office to overcome traffic jam and save office time.

(iv) ₹ 3 lakhs spent on gift items distributed to various dealers under the company's sales incentive scheme.

(v) ₹ 6 lakhs being expenses incurred on the travelling of the wife of MD, who accompanied him on tour to Singapore on invitation of Trade and Commerce chamber, Singapore.

(vi) ₹ 3 lakhs being amount paid in March 2024 consequent upon change in currency rate due to exchange fluctuation in excess of the amount due to the supplier of machinery. Such second hand machinery was acquired and put to use on 10th September 2023.

(vii) ₹ 18,000 and ₹ 9,000 paid in cash on 25th August, 2023 by two separate vouchers to a contractor who carried out certain repair work in the office premises.

(viii) Interest of ₹ 2 lakhs was paid in September, 2023 to a company on a loan taken from it. Tax deducted at source, during P.Y. 2023-24, from such interest was deposited in April 2024.

Additional Information:

(a) Audit fee of ₹ 6 lakhs was credited during previous year 2022-23 without deducting tax at source. Such fee was paid to the auditors in September, 2023 after deducting tax under section 194J and the tax so deducted was deposited on 7th December, 2023. 30% of audit fee was disallowed while computing income for financial year 2022-23.

(b) During financial year under consideration, the company purchased 10,000 shares of AB Private Limited out of its total 2 lakh shares at ₹ 40 per share. The fair market value of such shares on the date of transaction was ₹ 60 per share.

(3) Manoj assisting CA Sakshi Ahuja

Mr Amit, the director of SSI Pvt. Ltd. visited CA Sakshi Ahuja who is handling all customs related works of clients for past 7 years. The company imported machinery from USA by air for which the details are given under.

Purchase cost of Machinery	**$ 7,000**
Accessories worth US $ 2,000 compulsorily supplied with machine, price of which is included in price of machine	
Air Freight	$ 2,000
Insurance	$ 100
Local Agent Commission (not buying commission)	₹ 4,500
Exchange Rate with respect to INR	1 $= 70
Custom Duty on Machine	10% ad valorem
Custom duty on Accessory	20% ad valorem
Integrated Tax	12%
GST Compensation cess	Nil
SWS (Social Welfare Surcharge)	10%

I. Multiple Choice Questions

1. With reference to the Information given in point (3), compute the FOB value of machinery purchased by SSI Pvt. Ltd. as per the Customs Act, 1962.

   (a) ₹ 4,90,000

   (b) ₹ 4,94,500

(c) ₹ 6,30,000

(d) ₹ 6,37,000

2. With reference to the Information given in point (3), compute assessable value of machinery purchased by SSI Pvt. Ltd. as per the Customs Act, 1962.

(a) ₹ 6,00,400

(b) ₹ 6,37,000

(c) ₹ 6,41,500

(d) ₹ 7,81,500

3. With reference to the Information given in point (3), compute the total customs duty and integrated tax payable as per the Customs Act, 1962 by SSI Pvt. Ltd. in respect of imported machine.

(a) ₹ 1,54,918

(b) ₹ 1,46,017

(c) ₹ 1,56,013

(d) ₹ 1,90,060

4. With reference to the Information given in point (2), compute the Income of MVS Private Limited taxable under the head "Income from other sources".

(a) ₹ 4,00,000

(b) ₹ 1,50,000

(c) ₹ 2,00,000

(d) Nil

5. Existence of which of the conditions would make it appropriate for Shivalik Construction Private Limited to recognise revenue only to the extent of costs incurred?

(i) The goods do not represent a distinct performance obligation

(ii) The goods represent a distinct performance obligation

(iii) Customer is expected to obtain control of the goods significantly before receiving the services

(iv) Cost of such goods is significant relative to the total expected costs to complete the performance obligation and

(v) The entity procures the goods from a third party and does not significantly involve in designing / manufacturing the goods (even if the entity is a principal in the arrangement between the entity and end customer).

In the above context, which of the following is correct combination:

(a) (i), (ii), (iii), (iv), (v)

(b) (i), (iii), (iv), (v)

(c) (ii), (iii), (iv), (v)

(d) (i), (ii), (iii), (iv)

II. Descriptive Questions

6. Compute total income of MVS Private Limited for Assessment Year 2024-25 and tax liability under Income-tax Act, 1961 on such income indicating reasons for treatment of each item. Ignore provisions relating to minimum alternate tax. Assume that company does not opt for provisions of section 115BAA (Turnover of company for previous year 2021-22 was ₹ 250 crore)

7. How will Shivalik Construction Private Limited recognize revenue as per the relevant Ind AS, if performance obligation is met over a period of time?

ANSWERS TO THE CASE STUDY 34

I. Answers to the Multiple Choice Questions

1. (b) ₹ 4,94,500

Reason:

Particulars	Amount
Cost of machinery inclusive of accessory (FOB) (See note)	7,000
Total (in Indian ₹) FC 7000 * ₹ 70 (being Exchange Rate)	₹ 4,90,000
Add: Local Agency Commission	₹ 4,500
FOB Value as per Customs	₹ **4,94,500**

Note:

1) Accessories and spare parts compulsorily supplied with main implements are chargeable at the same rate applicable to main machine. Therefore, such accessories shall also be chargeable with duty at the rate applicable to the machinery i.e. 10% ad valorem

2) Agency Commission, which is incurred in India, is not regarded as Buying Commission and therefore will be added to determine customs FOB Value.

2. (a) ₹ 6,00,400

Reason:

Particulars	**Amount**
Cost of machinery inclusive of accessory (FOB) (See note)	7,000
Total (in Indian ₹) FC 7,000* ₹ 70 (being Exchange Rate)	₹ 4,90,000
Add: Agency Commission	₹ 4,500
FOB Value as per Customs	**₹ 4,94,500**
Add: Cost of insurance (FC 100 * ₹ 70)	₹ 7,000
Add: Air freight restricted to 20% of FOB Value as per customs	₹ 98,900
CIF Value/Assessable Value	**₹ 6,00,400**

Note: Actual Air freight is FC 2,000, it is limited to 20% of Custom FOB value of Goods as per Rule 10(2) of the Custom Valuation(Determination of valuation of imported goods) Rules, 2007.

3. (b) ₹ 1,46,017

Reason:

Particulars		**Amount (₹)**
Assessable Value	(A)	6,00,400
Add: Basic Custom Duty (10%)	(B)	60,040
Add: SWS @10% on BCD	(C)	6,004
Total for Integrated Tax u/s 3(7) of the Customs Tariff Act,1975	(D)	6,66,444
Integrated Tax @ 12% of ₹ 6,66,444 (rounded off)	(E)	79,973

Total Custom Duty Payable = (B) + (C) + (E) i.e. ₹ 1,46,017

4. (c) ₹ 2,00,000

Reason: Income from other sources- Difference between the aggregate fair market value of shares of a closely held company and the consideration paid for purchase of such shares is deemed as income in the hands of the purchasing company under section 56(2)(x). Since the difference exceeds ₹ 50,000, the entire sum is taxable.

10,000 shares * (60 - 40) = ₹ 2,00,000

5. (b) (i), (iii), (iv), (v)

Reason: While applying input method, a careful consideration should be given for events that do not depict a direct relationship between entity's inputs and transfer of control of goods or services. For example, when cost-based input method is used, an adjustment may be required when cost incurred is not proportionate to entity's progress in satisfying its performance obligation**.** In such cases, the best reflection is to adjust the input method to recognise revenue only to the extent of costs incurred**.** Such recognition of revenue to the extent of costs incurred is appropriate, if at contract inception, all the following conditions exist:

(i) The goods do not represent a distinct performance obligation;

(iii) Customer is expected to obtain control of the goods significantly before receiving the services;

(iv) Cost of such goods is significant relative to the total expected costs to complete the performance obligation; and

(v) The entity procures the goods from a third party and does not significantly involve in designing / manufacturing the goods (even if the entity is a principal in the arrangement between the entity and end customer).

II. Answers to the Descriptive Questions

6. Computation of total income of MVS Private Ltd. for A.Y. 2024-25

Particulars	Amount (₹)
Profits and gains of business or profession	
Net profit for the year as per profit and loss account	75,00,000

Add: Expenses debited to profit and loss account but not allowable	
Contribution to Employees' Welfare Trust disallowed under section 40A(9)	2,00,000
Note: Alternatively, contribution to Employees Welfare Trust can be regarded as labour welfare expenditure and hence, can be allowed as deduction under section 37 as the payments were made on the ground of assessee's business exigencies [*CIT v. Cheran Transport Corp. Ltd. (Mad.)*]	
Expenses on course fee and hostel expenses for MBA course of a close relative of a director, who is not in employment of MVS Private Ltd., is not deductible under section 37 [*Enkay (India) Rubber Co. Ltd. V CIT*] Such expenditure is not incurred wholly and exclusively for the purposes of business. Hence, it should be added back to compute business income.	7,80,000
Expenses on installation of traffic signal, to facilitate its employees to overcome traffic jam and be on time, is in the interest of the business so that the work gets completed on time, and is hence, an allowable expense under section 37(1) [*Infosys Technologies Ltd. v. CIT (Bangalore)*]	-
Expenses on distribution of gift items to dealers under sales incentive scheme would promote goodwill and is made in the interest of business. Such gifts are prompted by commercial expediency and hence, the expenditure is allowable under section 37(1) [*CIT v. Avery Cycle Industries Ltd. (Punjab & Haryana)*]	-
Expenses on travelling to Singapore of the wife of Managing Director on the invitation of Trade and Commerce Chamber, Singapore, is an allowable expense on the grounds of commercial expediency and business considerations. [*Hero Honda Motors Ltd. v. CIT (Delhi)*]	-
Increase in liability due to change in currency rate and paid to the suppliers of machinery is to be added to cost of the asset as per section 43A. Hence, it should be added back to compute business income.	3,00,000
Payments to a contractor for repair work in a day by two separate vouchers in cash, is not an allowable expense as per section	27,000

40A(3), since the aggregate payments in a day exceeds the limit of ₹ 10,000	
Interest of ₹ 2 lakhs paid in September, 2023, on which tax deducted at source was remitted to the government before the due date of filling of income tax return, is allowable as per section 40(a)(ia).	-
Total	88,07,000
Less: Expenditure allowable as deduction but not debited to profit and loss account	
Disallowed audit fees paid for the year ended 31.3.2023 for which tax was not deducted in the F.Y. 2022-23 but was deducted and paid in F.Y 2023-24, is allowable as deduction in the A.Y. 2024-25, as per the proviso to section 40(a)(ia)	1,80,000
Depreciation on the amount of ₹ 3 lakhs added in cost of Machinery was put to use for more than 180 days	45,000
Income under the head Profits & Gains of Business or Profession	**85,82,000**
Income from other sources	
Difference between the aggregate fair market value of shares of a closely held company and the consideration paid for purchase of such shares is deemed as income in the hands of the purchasing company other section 56(2)(x). Since the difference exceeds ₹ 50,000, the entire sum is taxable.	2,00,000
Total Income	**87,82,000**

Computation of tax liability of MVS Private Ltd. For the A.Y. 2024-25

Particulars	Amount (₹)
Tax on ₹ 87,82,000 @ 25%	21,95,500
Add: Health & Education cess @ 4%	87,820
Total tax payable	**22,83,320**

7. Costs to be incurred comprise two major components – elevators and cost of construction service

(a) The elevators are part of the overall construction project and are not a distinct performance obligation.

(b) The cost of elevators is substantial to the overall project and are incurred well in advance.

(c) Upon delivery at site, customer acquires control of such elevators.

(d) And there is no modification done to the elevators, which the company only procures and delivers at site. Nevertheless, as part of materials used in overall construction project, the company is a principal in the transaction with the customer for such elevators also.

Therefore, applying the guidance on input method as provided under Ind AS 115, 'Revenue from Contracts with Customers' –

- The measure of progress should be made based on percentage of costs incurred relative to the total budgeted costs.
- The cost of elevators should be excluded when measuring such progress and revenue for such elevators should be recognized to the extent of costs incurred.

The revenue to be recognized is measured as follows:

Particulars	**Amount (₹)**
Transaction price	60,00,000
Costs incurred:	
(a) Cost of elevators	10,00,000
(b) Other costs	7,00,000
Measure of progress:	7,00,000/35,00,000 = 20%

Revenue to be recognised:	
(a) For costs incurred (other than elevators)	Total attributable revenue = 50,00,000 % of work completed = 20% Revenue to be recognised = 10,00,000
(b) Revenue for elevators	10,00,000 (equal to costs incurred)
Total revenue to be recognised	10,00,000 + 10,00,000 = 20,00,000

Therefore, for the year ended 31st March, 2024, the company shall recognize revenue of ₹ 20,00,000 on the project.

CASE STUDY 35

Wanton Terun Limited (WTL) is a fast growing listed company focussing on innovation in the Textile and Garments Industry. The Company has grown in last one decade from Punjab (India) to the homes of millions of customers across 50 countries and is aiming the target of becoming the most trusted brand that takes conscious care of its customers, employees and all stakeholders, and treats them 'the best.' Company also has 5 subsidiaries operating outside India in the same business line of garments and trading of some special types of yarns. Financial Statements of the Company for the financial year 2023-2024 have already been prepared and audit was completed as per all regulatory requirements.

After gaining experience as CFO of the Company WTL for last 15 years, Tiru has resigned and started his own venture in professional consultancy with some other players in the same business domain. Management of the Company gave an advertisement in all leading newspapers for hiring qualified professional for the vacant post of CFO. Fifty applications were received by the Company and all the candidates were competent and had good exposure in financial reporting, corporate governance, MIS reporting, capital budgeting, direct and indirect tax matters.

Management of the Company decided to have interview board for selecting the appropriate candidate for the post of CFO. After looking at the recent developments in various areas relating to the operations of the Company, accounting and other technical aspects of Companies Act, GST etc., following issues (as per books of accounts of the company) were selected on which opinion of all the candidates was sought and whosoever gives the correct response will be selected for next round of interviews. You are also interested in this job profile and have been asked the following issues during the interview:

Issue 1

Company is operating in 50 countries, so employees of the Company travel worldwide to oversee the operations and for business expansion. For this purpose, foreign currency is taken from authorized dealers (who charge GST as per relevant provisions of GST Law and applicable valuation guidelines) and used for meeting all overseas expenses including stay, local travelling and food expenses in foreign countries. For the upcoming business trip, employees will be travelling to United States of America and require US$ 10,000. Company purchased foreign currency (9900 US$) by paying ₹ 7.40 Lakhs, however the customs exchange rate and bank buying rate on the same will lead to amount of ₹ 7.45 Lakhs and ₹ 7.50 lakhs respectively for equivalent number of dollars on the same date.

During the last overseas visit of Senior Vice President (Marketing), the Company received export order for specified types of garments for which yarn was required to be imported. Company imported special yam from Germany for manufacture of garments. There was no

transaction value available for such yarn. Consequently, transaction value of identical goods under customs was considered.

Issue 2

One of the overseas subsidiaries SSS Inc. has provided financial assistance to WTL. The said financial assistance is outstanding in the books of accounts of the Company as Foreign Currency Loan (FCL) on which it paid an interest of₹ 32Crores in the last financial year. The amount of TDS, as applicable, has been deducted and deposited within the due date. Profits before interest, taxes, depreciation and amortization (EBITDA) of the borrower in the previous year were ₹ 100 Crores and the amount of depreciation was ₹15 Crores.

Issue 3

Company has to comply with listing obligations and disclosure requirements relating to corporate governance and for this, independent and a qualified audit committee is already formed and functioning. The audit committee consisted of six directors (having wide experience in corporate matters) with four of them being independent directors. One of the directors P (an independent director) has resigned as a director of the Company. WTL proposes to appoint Q as an independent director who is already serving as managing director in one company and independent director in three other listed entities.

Issue 4

Arunima is woman director of the Company. Due to her other engagements, she tendered her resignation from directorship with effect from 1stMarch 2024, vide her letter dated 15thFebruary 2024, which was received by the Company on 20thFebruary 2024. The Board took note of the resignation in its meeting held on 15thMarch 2024.

Issue 5

Aver Private Ltd was acquired by WTL and the same was accounted as a business combination as per Ind AS 103. However, there was an existing share-based scheme in Aver Private Ltd with a vesting condition for 4 years in which 3 years had already lapsed at the date of acquisition. WTL agreed to replace the existing award for the employees of the acquired entity. The fair value of the option under share-based payment scheme on acquisition date was ₹ 1,200, while the fair value of option replacing the existing scheme was ₹ 1,500. Also, only one more year was left for vesting after the acquisition.

I. Multiple Choice Questions

1. In respect of purchase of foreign currency from authorized dealer, whether the GST will be applicable and if yes, what will be the value of services on which GST will be charged under rule 32(2)(a) of the CGST Rules, 2017? Also calculate the GST amount assuming tax rate @ 18%.

(a) GST will be applicable on these services and the value of services will be ₹ 7,450. GST amount will be ₹1,341

(b) GST will be applicable on these services and the value of services will be ₹ 7,400. GST amount will be ₹ 1,332

(c) GST will be applicable on these services and the value of services will be ₹ 5,200. GST amount will be ₹ 936

(d) GST on transactions below US$ 10,000 is specifically exempted, so GST will not be applicable.

2. With respect to facts given in Issue 2 above, the interest to be reported by tax auditor under the form 3CD of Income-tax Act, 1961 would be:

(a) ₹ 30 Crores and ₹ 2 Crores under clause 30B

(b) ₹ 32 Crores and ₹ 2 Crores under clause 30B

(c) ₹ 32 Crores and ₹ 34.50 Crores under clause 30A

(d) ₹ 32 Crores under clause 30A

3. In the background of circumstances described in Issue 3, the Company Secretary contends that the Audit Committee should be reconstituted, even if Q is appointed as an independent director. Is the Company Secretary's contention appropriate?

(a) Contention of Company Secretary is correct and the Audit Committee should be reconstituted, as it should have atleast 2/3rd majority of members as independent directors.

(b) Contention of Company Secretary is not correct and the existing Audit Committee can continue as independent directors constitute more than two third of the total number of directors of audit committee.

(c) Contention of Company Secretary is correct and the Audit Committee shall be reconstituted, as it should have only independent directors as members.

(d) Contention of Company Secretary is not correct and the Audit Committee is not required to be reconstituted due to change in its members.

4. WTL shall appoint another woman director on the Board of the Company on or before:

(a) 1st June 2024

(b) 20th May 2024

(c) 15th June 2024

(d) 15th May 2024

5. Which of the following statements is correct in relation to import of yarn for which transaction value of identical goods was considered under Customs?

   (a) The transaction value of identical goods in a sale at any commercial level and in substantially the same quantity as the goods being valued shall be used to determine the value of imported goods.

   (b) The transaction value of identical goods in a sale at same commercial level and in any quantity as the goods being valued shall be used to determine the value of imported goods.

   (c) The transaction value of identical goods in a sale at same commercial level and in substantially the same quantity as the goods being valued shall be used to determine the value of imported goods.

   (d) The transaction value of identical goods in a sale at any commercial level and in any quantity as the goods being valued shall be used to determine the value of imported goods.

II. Descriptive Questions

6. Mr Q, before accepting the appointment as a director, discussed with the Company about the implications of GST on his appointment and emoluments. Explain if the services provided by the directors are under the ambit of Goods and Services Tax law.

7. In the background· of facts stated in issue 5, compute the value of option under the share based payment as per Ind AS 102.

ANSWERS TO THE CASE STUDY 35

I. Answers to the Multiple Choice Questions

1. (b) GST will be applicable on these services and the value of services will be ₹ 7,400. GST amount will be ₹ 1,332

Reason: Rule 32 of the CGST Rules, 2017 — Determination of value in respect of certain supplies

The value of supply of services is difference between buying rate or selling rate of currency and RBI reference rate for that currency at the time of exchange multiplied by total units foreign currency.

However, if RBI reference rate for a currency is not available then value of supply is 1% of the gross amount of Indian Rupees provided/ received by the person changing the money.

In the given case, RBI reference rate for a currency is not available, thus value of supply is 1% of the gross amount of Indian Rupees provided/ received by the person changing the money.

Value of Services = 1% x ₹ 7,40,000= ₹ 7400

18% GST thereon = 18% x ₹ 7400 = ₹ 1,332

2. (b) ₹ 32 Crores and ₹ 2 Crores under clause 30B

Reason: Clause 30B requires reporting for the purposes of examining allowability of expenditure by way of interest in respect of debt issued by non-resident associated enterprise under section 94B, while computing income under the head 'Profits and Gains of Business or Profession."

The excess interest to be computed as lower of:

(i) Total interest paid or payable in excess of 30% of earnings before interest, taxes, depreciation and amortization (EBITDA) of the borrower in the previous year or

(ii) Interest paid or payable to the associated enterprise for that previous year

3. (a) Contention of Company Secretary is correct and the Audit Committee should be reconstituted, as it should have atleast 2/3rd majority of members as independent directors.

Reason: Every listed entity shall constitute a qualified and independent audit committee in accordance with the terms of reference, subject to the following:

(i) The audit committee shall have minimum three directors as members.

(ii) At least two-thirds of the members of audit committee shall be independent directors and in case of a listed entity having outstanding SR equity shares, the audit committee shall only comprise of independent directors

4. (a) 1st June 2024

Reason: Proviso to Rule 3 of the Companies (Appointment of Directors) Rules, 2014 provides any intermittent vacancy of a woman director shall be filled up by the Board at the earliest but not later than immediate next board meeting or three months from the date of such vacancy whichever is later.

5. (c) The transaction value of identical goods in a sale at same commercial level and in substantially the same quantity as the goods being valued shall be used to determine the value of imported goods.

Reason: In applying rule 4 of the Customs Valuation (Determination of Value of Imported Goods) Rules, 2007, i.e. transaction value of identical goods, the transaction value of identical goods in a sale at the same commercial level and in substantially the same quantity as the goods being valued shall be used to determine the value of imported goods.

II. Answers to the Descriptive Questions

6. Services provided by the independent directors who are not employees of the said company to such company, in lieu of remuneration as the consideration for the said services, are clearly outside the scope of Schedule III of the CGST Act, 2017 and are **therefore taxable.**

As per Schedule III of the CGST Act, 2017 services by an employee to the employer in the course of or in relation to his employment are non-supplies, i.e. they are neither supply of goods nor supply of services.

Further, tax on services supplied by a director of a company to the said company located in the taxable territory **is payable by the recipient under reverse charge.**

Thus, services provided by Mr. Q, being an independent director to WTL, are taxable under reverse charge and tax on emoluments payable to Mr. Q is payable by the company (WTL) on reverse charge basis.

7. Computation of Value of Option under the share based payment

Pre-acquisition period		3
Post-acquisition period		1
Total fair value at acquisition date		₹1,200
Value to be recorded as per business combination underInd AS 103		₹1,200/4 X 3 = ₹900
Value to be recorded as perIND AS 102	**(A)**	₹ 1,200 /4 X 1 = ₹ 300
Fair value of the replacement of such award		₹1,500
Difference from acquisition date fair value	**(B)**	₹1,500 - ₹1,200 = ₹300
Total value to be accounted over vesting period	**= A + B**	₹300 + ₹300 = ₹600

ALTERNATE ANSWER

Pre-acquisition period	3
Post-acquisition period	1
Total fair value at acquisition date	₹1,200
Value to be recorded as per business combination	₹1,200/4 X 3 = ₹900

Since the fair value of the new award at the time of acquisition is ₹ 1,500, balance ₹ 1,500 -₹900 i.e. **₹ 600 will be recorded as an employee expense in the books.**

CASE STUDY 36

StayInn Limited is a well established company that runs chains of hotels and resorts across different locations in India.

"StayInn Budget" hotels

The hotels operate as budget hotels and operate under the brand "StayInn Budget". It provides accommodation for cost-conscious travellers visiting the city for short stay lasting a day or two. Typically a room in "StayInn Budget" hotels would provide comfortable beds, high speed internet connection, air conditioning facility, coffee machine, fridge and free television service. Food service based on a limited menu is provided on the premises. It has few conference rooms that provide space for guests to hold business meetings. This saves them precious time otherwise wasted in travelling on congested city roads. The hotel provides free shuttle service to and from the airport at specific times during the entire day. Proximity to the airport, the free shuttle service and convenience of conducting work at the conference rooms have been marketed to attract guests to stay here. The guests also comprise of people who are in transit between airports. Also when there are long-duration delays in flight operations due to which passengers need to be provided overnight accommodation, few airline operators host their guests here. Like all other guests, these airline operators are also interested in for its location and low-cost room rental.

In all, StayInn Limited has 15 hotel properties spread over 15 cities. All of them function under the "StayInn Budget" brand catering to cost-conscious travellers. In all these establishments, since the location of the hotel is near the city airport, the real estate cost, both for ownership and rental is very high. Hence, instead of having an in-house establishment for cleaning and food service, the company has outsourced these services to specialized vendors. This will reduce the additional space requirement needed to maintain the facilities to provide these services. This will help to keep its costs of operations within control. Since the hotel property is in the city, there is ample availability of vendors providing this service. Cleaning service includes cleaning of kitchen crockery, bedding, laundry and housekeeping of premises. Similarly, the entire set of activities related to preparation of food has been outsourced. Vendor service has been satisfactory, barring few instances where guests have complained of unhygienic rooms or non-palatable food service. However, due to high guest volume and quick turnover of guests due to short stay periods, this has never been a hindrance to business.

This business model has been profitable since its establishment. StayInn Limited has a sizeable market share in this segment. Competition has increased in the recent past. Price wars have put pressure on profit margins of the budget hotel segment. Room rates are increasingly being determined by the prevailing market rates in the respective locations

"StayInn Comfort" Resorts

The management plans to continue to operate in the budget hotel to maintain its market presence. At the same time, to sustain business in the long term, the management of StayInn Limited has forayed into developing properties for luxury resorts under a separate new brand called "StayInn Comfort". Target guest segment are vacationing tourists interested in a enjoying a laid-back time in scenic places. These guests would not mind paying premium for availing good quality service. Maintaining cleanliness of premises and food service are critical activities in the operation of luxury hotels. Unlike cities, the location of these resorts is in more sparsely populated areas. While there are vendors providing cleaning and food services, there are limited options to choose from.

Customer satisfaction is paramount to sustain and grow business in the luxury resort segment. With the ability to post reviews online on booking portals, any negative review (whether justified or not) can reach very easily to a large number of potential guests. This can negatively impact future business.

StayInn Limited is developing a "StayInn Comfort" property in Goa. Below are the expenses being incurred to construct the new resort at Goa.

Particulars	Cost incurred (₹)
Purchase of land	15 crores
Site preparation costs, cost of dismantling existing structures on site	2 crores
Direct Material costs	8 crores
Direct Labour costs (including ₹20 lakh that was incurred during a labour strike)	3 crores
Testing the safety of construction at the resort site	0.5 crores
Consultation fee (Legal and architect) related to construction of resort	1.5 crores
Relocation of expense of resort manager from Mangalore to Goa	0.10 crores
Administration and General overheads allocated to the project by corporate office	0.50 crores

The property is being acquired from an unrelated party at arm's length transaction value. Five out of the six directors were present at the Board Meeting to consider and pass the resolution to acquire the property.

The operations at the Goa resort started as per the expected timeline. It is in its 3rd year of operations. At a recent management meeting, following is the information was made available for the "StayInn Comfort" Goa resort:

Particulars	Amount
Net Operating Profit before Interest and Tax	5 crores
Depreciation expense	3 crores
Change in working capital	4 crores
Capital expenditure	5 crores
Invested capital	20 crores
Weighted Average Cost of Capital (WACC)	8%
Tax Rate	30%

I. Multiple Choice Questions

1. For the "StayInn Budget" properties, identify the listed activities to the five primary activities of Michael Porter's value chain model.

Sr. No.	Listed Activity	Sr. No.	Primary activity as per value chain model
A	Storing vendor delivered freshly laundered crockery, bedding and laundry for future use as per guest requirements	I	Operations
B	Ensuring cleanliness and safety of rooms, working order of facilities offered like TV and internet service, coffee machines.	II	Marketing and Sales
C	The review of food items to remove the ones past expiry to ensure customer satisfaction and safety	III	Inbound Logistics
D	Free shuttle service to attract guests to stay at the hotel	IV	Service

E	Front desk activities handling complaints, customer support	V	Outbound Logistics

(a) A – I, B – III, C – IV, D – II, E – V

(b) A – III, B – I, C – V, D – II, E – IV

(c) A – I, B – IV, C – V, D – II, E – IV

(d) A – III, B – I, C – II, D – IV, E – V

2. As regards "StayInn Comfort" resorts, the parameters relating to high quality cleanliness and food service can be classified under which attribute of the following under the Kano Model?

(a) Performance attribute

(b) Delight attribute

(c) Threshold attribute

(d) Indifferent attribute

3. Which of the following statements is true as regards to the resolution taken at the Board Meeting to acquire the property in Goa?

(a) When all five directors of StayInn Limited attending the meeting consent to the acquisition of property

(b) When any four directors of StayInn Limited out of the five attending the meeting consent to the acquisition of property

(c) When any three directors of StayInn Limited out of the five attending the meeting consent to the acquisition of property

(d) When all six directors, representing the total strength of directors at StayInn Limited should consent to the acquisition of property

4. Calculate the Economic Value Added (EVA) of the "StayInn Comfort" Goa.

(a) ₹ 1.60 crores

(b) ₹ 4.60 crores

(c) ₹ 0.40 crores

(d) ₹ 1.90 crores

5. Which of the following statements would be true?

   (a) StayInn Limited should outsource all its cleaning and food service operations in all its properties ignoring the risks of outsourcing, if the cost of outsourcing is less than the cost of providing this service in-house. This is because the Economic Value Added (EVA) of the company will be positively impacted despite the risk of outsourcing.

   (b) StayInn Limited make an absolute comparison of Economic Value Added (EVA) of one property with that of another irrespective of the difference in scale of their respective operations.

   (c) StayInn Limited should reconsider the feasibility of operating properties where the Economic Value Added (EVA) is negative.

   (d) Economic Value Added (EVA) as a measure takes into account the current purchasing power and adjusts for inflationary trends. Hence, it is a more appropriate measure to track as compared to book profit.

II. Descriptive Questions

6. (a) Explain the risks of outsourcing cleaning and food services for the "StayInn Comfort" luxury resort properties.

   (b) What would your suggestion be, if the management of StayInn Limited determines that guests experience (primarily influenced by cleanliness of facilities and food service) is a very important critical success factor (CSF)?

   (c) How is this risk different from outsourcing cleaning and food services for the "StayInn Budget" hotel properties with that for "StayInn Comfort" resorts?

   (d) What benefit does StayInn Limited derive by operating different properties under two separate brands?

7. Identify the total costs to be capitalized under Indian Accounting Standard 16, Property, Plant and Equipment for the "StayInn Comfort" resort being developed in Goa.

ANSWERS TO THE CASE STUDY 36

I. Answers to the Multiple Choice Questions

1. (b) A – III, B – I, C – V, D – II, E – IV

Reason:

A Storing vendor delivered freshly laundered crockery, bedding and laundry for future use as per guest requirements – Inbound Logistics as it relates to activities of receiving, handling of materials from the supplier and their storage until further use later in operations.

B Ensuring cleanliness and safety of rooms, working order of facilities offered like TV and internet service, coffee machines – Operations as these are activities related to converting inputs into production of output or service.

C The review of food items to remove the ones past expiry to ensure customer satisfaction and safety – Outbound Logistics as it relates to storage and movement of the end product from the production line to the customer.

D Free shuttle service to attract guests to stay at the hotel – Marketing and sales as these are activities related to communicating, selling and delivering the product or service to the customer.

E Front desk activities handling complaints, customer support – Service includes after sale service, handling customer complaints, customer support, training etc. It is one of the most important activities in their value chain model. Good service ensures happy guests.

2. (c) Threshold attribute

Reason: Threshold attribute as this is feature that is taken for granted by the guests at the resort. However, if the required quality is not met it would cause dissatisfaction.

3. (a) When all five directors of StayInn Limited attending the meeting consent to the acquisition of property

Reason: the resolution will be taken as passed when all five directors of StayInn Limited attending the meeting consent to the acquisition of property

4. (d) ₹1.90 crores. EVA = NOPAT less capital charge on invested capital

Reason: Net Operating Profit After Tax (NOPAT) = Net Operating Profit before Interest and Tax Less Taxes

= ₹5 crores less 30% of ₹5 crores = ₹3.50 crores.

Capital charge on invested capital = WACC * Invested capital = 8% * ₹20 crores = ₹1.60 crores.

Therefore, EVA = ₹3.50 crores less ₹1.60 crores = ₹1.90 crores.

5. (c) StayInn Limited should outsource all its cleaning and food service operations in all its properties ignoring the risks of outsourcing, if the cost of outsourcing is less than the cost of providing this service in-house. This is because the Economic Value Added (EVA) of the company will be positively impacted despite the risk of outsourcing**.**

Reason:

StayInn Limited should reconsider the feasibility of operating properties where the Economic Value Added (EVA) is negative. Negative EVA implies that the profits from the property does not cover the cost of invested capital.

II. Answers to the Descriptive Questions

6. (a) Risks of outsourcing cleaning and food service under the luxury resort model:

In the luxury resort business under the brand “StayInn Comfort”, the target guests are travellers on leisure. The primary feature of this model would be "good quality of service". Maintaining cleanliness of premises and food service are critical activities in the operation of luxury hotels. Therefore, customer satisfaction on these metrics is paramount to sustain and grow business. With the ability to post reviews online on booking portals, any negative review (whether justified or not) can reach very easily to a large number of potential guests. This can negatively impact future business. Hence, “StayInn Comfort” brand has to deliver the quality of service that it provides in terms of cleanliness and food that should meet and beat the guests' expectation.

Outsourcing these services to well established vendors is advantageous since the focus can remain on improving guest experience. It may also be cost advantageous in many cases. However, there a number of risks in this model.

(1) The required quality of service for "StayInn Comfort" resort properties should be delivered by these vendors. Detailed service level agreements need to drawn up to ensure this. StayInn Limited should be able to monitor the performance of these vendors. In cases of non-delivery of the required level of service, the agreement should provide for means of redressal. This could vary from compensation for any loss in business to immediate termination of service.

(2) StayInn Limited should ensure that it can easily and economically switch service providers if required. For this it has to identify alternate vendors who can provide the same level of service as the current ones. At the same time, since the resorts are in locations where the number of vendors providing these services is limited, it increases the risk of outsourcing these services. The other risk in outsourcing could be of instances where well performing vendors could go bankrupt and shut shop. In such cases, resort operations could be immediately impacted since such services can no longer be availed from these vendors. Again, list of alternate service providers is a necessary back-up that the hotel should have.

(b) Where the management of StayInn Limited determines that guests experience (primarily influenced by cleanliness of facilities and food service) is a very important critical success factor (CSF) it may choose not to outsource these activities to outside vendors. Quality control issues and poor customer service may wipe out any cost savings attributed to lower expenses from the outsourcing model. StayInn Limited would then have to consider developing in-house departments that cater to cleanliness and food service. Control over factors such as input material used, the performance of service, equipment used, training of staff and other essential activities can ensure that the required service quality can be achieved. Better service enhances guest experience through these critical activities. Compared to outsourcing, this might be a costlier option. However, since the guests are ready to pay a premium for service quality, StayInn Limited could choose to charge higher rates for its resort properties.

(c) The difference between the risk of outsourcing for "StayInn Comfort" and "StayInn Budget" driven by the difference in the focus and target customer segment of their respective business models. "StayInn Budget" focuses on providing value for money to the cost conscious short stay guests while "StayInn Comfort" focuses on customer experience through quality of service provided to the guests staying on longer vacations.

As regards "StayInn Budget" due to high real estate cost, both for ownership and rental, the cleaning and food service has been outsourced. This enables StayInn Hotels to keep the costs of operation low, which is very critical for the business model of "StayInn Budget". Hence, instances of dis-satisfaction among guests as regards quality of cleaning and food service, within certain limits will not negatively impact business. These activities are non-core and hence can be considered for outsourcing. For "StayInn Budget", the critical success factor (CSF) is low cost of operations in order to be able to offer guests rooms at reasonable rates.

As regards "StayInn Comfort" where CSF is guests experience, which is primarily influenced by cleanliness of facilities and food service, these activities become core activities, hence the risks of outsourcing are higher. Therefore, there may need to be a consideration whether to outsource these activities at all. Pricing for rooms at these resorts can factor any additional costs to be incurred to ensure the delivery of the required quality of service in these resorts.

(d) Branding of properties under either "StayInn Budget" and "StayInn Comfort" makes helps potential customers determine their expectations from each of such properties. Based on these expectations the customer appeal can be distinctly determined for each of these properties. This will help them choose which property could potentially satisfy their expectations better. Thus by operating different properties under either "StayInn Budget" or "StayInn Comfort" brand, StayInn Limited has created a brand strategy that can effectively communicate their product and service offering to potential customers.

7. Computation of total cost of construction of StayInn Comfort" resort being developed in Goa as per Indian Accounting Standard 16, "Property, Plant and Equipment"

Particulars	Cost incurred (₹)
Purchase of land	15 crores
Site preparation costs, cost of dismantling existing structures on site	2 crores
Direct Material costs	8 crores
Direct Labour costs (including ₹20 lakh that was incurred during a labour strike)	2.8 crores
Testing the safety of construction at the resort site	0.5 crores
Consultation fee (Legal and architect) related to construction of resort	1.5 crores
Total cost to be capitalized StayInn Comfort" resort being developed in Goa as per Indian Accounting Standard 16.	29.80 crores

Relocation expense of hotel manager from Mangalore to Goa and administrative and general overheads allocated to the project by corporate office are not capitalized under Indian Accounting Standard 16. Direct labour costs incurred during a labour strike is not attributable to construction of resort and hence not capitalized. All other costs are directly attributable to the construction of the resort.

CASE STUDY 37

Background

Riddhi and Siddhi are siblings residing in a remote village in north-east India. Over the years Riddhi and Siddhi observed that rampant and unchecked industrialisation is causing irreparable damage to the local environment and create health related issues for the residents. Dwindling air quality further added to the health-related issues.

The siblings graduated from a renowned medical college from Delhi. Armed with medical knowledge, they incorporated RISI Limited – a super-speciality hospital. The 303-bed hospital established in Assam delivers the highest quality of medical care through its team of expert doctors, nurses, technicians and management professionals. The hospital has Centres of Excellence in oncology, including surgical, non-interventional cardiology, cardiac surgery, gastroenterology and kidney transplant and neurology. The hospital also has robust critical care capabilities both adult and paediatric. Their business grew exponentially, and the equity shares of the Company were eventually listed on the Bombay Stock Exchange. Riddhi and Siddhi were appointed as Directors on the Board of the Company.

The current status of RISI Limited described as follows:

Since incorporation the mission of the Company remained consistent basis the initial understanding of the Founders i.e. ***to create a world-class integrated healthcare delivery system in India, entailing the finest medical skills for finest clinical excellence and distinctive patient care.*** Since then, the mission has not been revised. In quarterly meetings senior management expresses their desire to improve profitability, result oriented, innovate and learn. Occasionally, in informal meetings employees are told to work ethically and honestly.

The general environment, in which RISI Limited operates, is made up of elements of the broader community that have an influence on the healthcare industry and the company within it. There is a trend towards continuous research and development for the treatment of cancer, AIDS and the improved quality of life. More complex diagnostic equipment is being utilised on a daily basis in the healthcare industry, an example is the challenges of microscopic and endoscopic surgery.

RISI Limited analyse the internal and external environment of the organisation. It is thus how; the organisation's resources are allocated optimally by considering the analyses done, to achieve its goals. The plan devised as part of strategy illustrates the aims to improve the

organisation's position and how it plans to respond to its external environment and where it needs to position itself to maximise its strengths and gain success in doing so.

RISI Limited has a flat fee structure as it believes in easy access to affordable healthcare systems. The Company has cost effective prices in relation to its competition. This strategy had indeed made a mark for the Company in the State of Assam. However, due to increased earnings, newer generations, expects a better healthcare experience for which they are willing pay an extra amount.

The implications of technological advances have created opportunities for RISI Limited to research and form guidelines and protocols for the use of any new technology to try and curb unnecessary expenditure, by ensuring that it is used cost-effectively, appropriately and rationally. During the last year, the Company attempted to enter into a joint venture with an entity specialising in treatment of cancer. However, the attempt failed. In the current year, the Company tried to enter into a strategic alliance with an entity undertaking research in AIDS. Despite multiple attempts the deal did not go through. As per Company's own estimate, these two alliances would have provided a significant fillip to the diminishing profitability of the Company.

The RISI Limited reduces the costs of medical facilities by controlling the behaviour of patients and healthcare providers. Control functions manage the interfaces between healthcare services, thus through this, a continuum of internal control to transactional control is exercised. The Company especially owns strategic value in terms of their technological resources: computer soft- and hardware and also in the financial and organisational resources that have been put in place.

The Company require its professionals to have a wide range of technical skills to provide the best healthcare services and soft skills to provide the best possible patient care. These professionals employ unique skills depending on the patient and situation. Healthcare capabilities help engaging with patients, influence how to communicate with them and provide optimum healthcare services. These skills help the Company showcase why it is an ideal choice and what differentiates the Company from competitors. The development of human capital is deemed to be part of the management of knowledge by the Company. Human capital refers to the knowledge and skill of all the employees.

RISI Limited has in the past invested in the training and further development of personnel, as training and development is essential to ensure that personnel know how to do their jobs and at the same time keep up to date with the latest techniques and technology. Separate budgeting was done for development and training purposes.

Management and employee performance indicate that the Company has employed many skilled and capable staff. Unfortunately, it has not made provision for the rapid growth that has taken place in the organisation. Recognition and growth opportunities appear to be the greatest problems experienced at this time. There is also no reward system for excellence.

The Company believes that performance reviews are crucial to the forward progress of both organization and the employees who operate them. These reviews are expected to improve team productivity and workplace satisfaction. The Company follows traditional performance appraisals. A manager and employee meet to review the employee's work performance annually. There are no set time limits on the completion of performance reviews. Typically, it was observed that a large number of employees on an average spends 15 minutes spend time with their manager at the end of the every year to discuss their performance. A preset rating system is used to guide the conversation. These rating criteria were framed by the Founders in discussion with a renowned consultant having expertise in manufacturing sector.

Decision-making systems in the Company are utilised within the organisational context, they range from budget and financial systems to very structured computer systems and even complex expert systems. These systems work in silos. The strategic value that has been added by these system has contributed to the development of staff skills and abilities and thus to the company’s competitive advantage. Recently, the Company had hired an external consultant to suggest new systems. These new systems use cutting edge technologies and involve the use of generative technologies, machine learning and artificial intelligence. These new systems, if implemented across the Company’s value chain would significantly overhaul the Company and usher the entity into a new era of data management and objective decision making. The Company is apprehensive of using the these new tools.

The decision-making systems are diverse and meet the requirement of every department. A large part of the data required for decision making purpose is maintained in spreadsheets by a capable and dedicated team of professionals. For decision making at the higher level a separate team of professionals are employed to extract the data from peripheral systems of every department and feed the data into the main system of the entity.

the organisation’s different departments or units relate to each other, and have been described in the organisation charts and group and ownership structures. The Company has been divided in four main functions and are regarded and function as independent profit centres. These Strategic Business Units (SBUs) form is part of a multidivisional structure, which consists of the top level being corporate headquarters. The units function as profit centres and are thus responsible for their own budgets. They are to continuously follow through on their own

objectives and strategies. These business units have their own core functions, but share common business, financial, administrative, and human resource policies.

Company's culture and employees' common and shared way of behaving and thinking. RISI Limited values and culture has been built on a foundation of absolute honesty, professional integrity, capability and quality. The company is very supportive in terms of its human capital. Any partnerships that are entered into are for shared advantage and to have created a winning recipe.

The Company makes a point of focussing all new staff towards a client and results orientation. Another very important, almost critical element of RISI Limited is the management and warehousing of data, as well as the leverage of information technology. It has been ingrained in the culture that service quality is extremely important, and a high service level and service quality is to be maintained all the time.

The Company's staff is made up mostly of healthcare professionals, information technology staff and office support staff. Staff members become major stakeholders in the organisation, as their employment provides job security and job satisfaction. The Company's staff refers to the type of people employed in the organisation with their different backgrounds, orientation towards clients, values and technology that makes the organisation successful. The organisation hires able people, train them well and assign them to the correct jobs. RISI Limited has always maintained an excellent reputation in the healthcare industry in terms of their knowledge resources; they have been known to be non-confrontational and rather to negotiate. Joint Ventures that they have entered into supports the brand name further.

A majority of the staff in the initial level comprise of female health care professionals. However, in middle and top level, the gender ratio is skewed toward the male professionals. A recent study shown that the Company losses 30% of its female work force in every 3 years. The Company has regular alumni meet to meet the ex-employees.

For the purpose of book closure of the financial statements for the current year – 31 December 20X4, Riddhi and Siddhi, met Ms Nidhi, CEO of the Company along with the auditor to discuss the audit plan and audit observations, if any. Ms Nidhi informed that the Company is expected to earn profits during the current year. The auditor highlighted that the audit is progressing and the observations till date are as follows:

Issue – 1

RISHI Limited had entered into a contract with Vahan Chalak Limited- a transport agency - to use a particular ambulance van specified in the contract for a period of 7 years. Vahan Chalak

can substitute another ambulance van only in case of breakdown of the van. As per the terms of contracts, during the 7-year contract period, the driver hired by RISHI Limited can operate the van and RISHI Limited decides how to use the van (such as when it is used and on which route it will operate). However, there are certain contractual limitations to protect the interest of Vahan Chalak in the truck, i.e., restrictions on making modifications.

Issue – 2

USA Chemical, an entity domiciled in USA, manufactures, and sells life saving drugs. RISI Limited entered into a contract:

- Involving purchase of 2 cartons of chemical on 1 October 20X4, when the price of the chemical is USD 100,000 per KG
- Delivery date of chemical 31 January 20X5 (conversion rate INR 160 = USD 1).
- Paid an upfront deposit of USD 40,000 (conversion rate INR 100 = USD 1) to the supplier.
- Deposit will be deducted from the total purchase consideration which is due to be paid on 28 February 20X5 (conversion rate INR 150 = USD 1).

Issue – 3

During the year remuneration of INR 2,00,00,000 was paid to Ms Nidhi, the CEO of the Company. Ms Nidhi is a Chartered Accountant with deep experience in recycling industry. ESOPs were issued as follows:

- *First tranche of 7,000 equity settled ESOP granted at the beginning of the year*
  - Grant date fair value INR 100 per ESOP
  - Vesting, exercise (at nil exercise price) of ESOP and allotment of equivalent equity shares were completed by the year end.
  - Exercise date fair market value: INR 150 per ESOP.
  - Allotted shares constitute 0.1% of paid up share capital.
- *Second tranche of 3,000 ESOP were also granted at the beginning of the year*
  - Vest period would end by the end of the next year.

As per the auditor the managerial remuneration paid to Ms Nidhi exceed the prescribed limits as follows:

	Rounded to nearest INR lakhs
Profit before tax– as per Statement of Profit and Loss	1,000
Less: Unrealised gain of INR 10 lakhs	(10)
Net profit under section 198 of the Companies Act, 2013	990
Maximum limit under section 198 of the Companies Act, 2013	109 (11% of above net profits)
Salary paid and recognised in the Statement of Profit and Loss	100
Excess managerial remuneration	9

Issue – 4

RISI Limited had entered into a contract with SIRI LLP to purchase certain materials. Majority of the capital of SIRI LLP is held by IRIS LLP whose majority capital is held by Vaani Sole Proprietor incorporated by a friend of Riddhi. IRIS LLP holds 5% of share capital of RISI Limited. The key terms and conditions are as follows:

- Initially 10,000 KG of material will be purchased for INR 600 crores.
- Subsequently 15,000 KG of material will be purchased for INR 500 crores.

The CEO of the Company believes that the above transaction is not a related party transaction under SEBI Listing Regulations.

I. Multiple Choice Questions

1. Assuming that the conversion rate of USD 110 = USD 1 exist as on 31 December 20X4, at what amount should the foreign currency deposits and foreign currency trade payable be recognised in the financial statements for the year ended 31 December 20X4?

   (a) Recognise foreign currency deposit at INR 44 lakhs and foreign currency payable at INR 1.76 crores. The foreign currency deposit and foreign currency payable should be translated using the exchange rate as at year end 31 December 20X4.

   (b) Recognise foreign currency deposit at INR 60 lakhs and foreign currency payable at INR 1.76 crores. The foreign currency deposit and foreign currency payable should be translated using the exchange rate as at 28 February 20X5 (i.e.. the settlement date) and the exchange rate at yearend 31 December 20X4 respectively.

(c) Recognise foreign currency deposit at INR 44 lakhs and foreign currency payable at INR 2.56 crores. The foreign currency deposit and foreign currency payable should be translated using the exchange rate as at 31 December 20X4 (i.e.. year end) and the exchange rate at 31 January 20X5 (i.e.. delivery date) respectively.

(d) Recognise foreign currency deposit at INR 40 lakhs. Foreign currency trade should not be recognised. The foreign currency deposit should be recognised using the conversion rate of 1 October 20X4 (i.e.. date of deposit).

2. Whether the computation of excess managerial remuneration is in accordance with the provisions of the Companies Act, 2013?

(a) Yes–Managerial remuneration is within the prescribed limits

(b) No – Excess managerial remuneration is INR 7 lakhs

(c) No – Excess managerial remuneration is INR 3 lakhs.

(d) No – Excess managerial remuneration is INR 19 lakhs.

3. Whether the CEO is correct in her conclusion that the purchase of raw materials from SIRI LLP would not qualify as a related party transaction under SEBI Listing Regulations?

(a) Yes. SIRI LLP is not a related party as per SEBI Listing Regulations. Thus, any transaction with SIRI LLP would not qualify as a related party transaction under SEBI Listing Regulations.

(b) No. SIRI LLP is a related party as per SEBI Listing Regulations as it is controlled by a friend of Riddhi – a key managerial personnel of RISI Limited. Thus, any transaction with SIRI LLP would qualify as a related party transaction under SEBI Listing Regulations.

(c) No. Non-reduction of purchase consideration indicate that the purpose and effect of the transaction benefit Riddhi - a key managerial personnel of RISI Limited. Thus, any transaction with SIRI LLP would qualify as a related party transaction under SEBI Listing Regulations.

(d) Yes. Non-reduction of purchase consideration indicate that the purpose and effect of the transaction benefit Riddhi - a key managerial personnel of RISI Limited. However, the transactions are individually below the qualifying threshold of INR 1,000 crores. Thus, the transaction with SIRI LLP would not qualify as a related party transaction under SEBI Listing Regulations.

4. Whether the transaction for purchase of raw materials from SIRI LLP require approval of Audit Committee and/ or shareholders under the SEBI Listing Regulations?

   (a) Yes. Only approval of the Audit Committee is required since it is not a related party transaction.

   (b) Yes. Prior approval of the Audit Committee is required. Since the aggregate transactions exceed the qualifying threshold of INR 1,000 crores, prior approval of shareholder is also required.

   (c) Yes. Prior approval of the Audit Committee is required. Since the aggregate transactions exceed the qualifying threshold of INR 1,000 crores, approval of shareholder is also required.

   (d) Yes. Individually the transactions do not exceed the qualifying threshold of INR 1,000 crores. Accordingly, prior approval of the Audit Committee is required.

5. Which of the following strategic considerations should RISI Limited focus on to address emerging needs and improve its market position?

   i. Continue with the current flat fee structure without any changes.

   ii. Update the mission and strategic objectives to incorporate profitability, innovation, and ethical practices.

   iii. Need for a revised approach to partnerships and collaborations.

   iv. Implementing the new systems suggested by the external consultant, which involve generative technologies, machine learning, and AI.

   Options

   (a) i, ii

   (b) ii, iii

   (c) iv only

   (d) iii, iv

II. Descriptive Questions

6. Whether RISHI Limited has the right to direct the use of the ambulance van while assessing the lease contract?

7. RECOMMEND how aligning actions and decisions with each element of the McKinsey 7S model can help RISI Limited enhance organizational effectiveness, resilience, and long-term sustainability in the healthcare industry while addressing potential inefficiencies and challenges?

ANSWERS TO THE CASE STUDY 37

I. Answers to the Multiple Choice Questions

1. (d) Recognise foreign currency deposit at INR 40 lakhs. Foreign currency trade should not be recognised. The foreign currency deposit should be recognised using the conversion rate of 1 October 20X4 (i.e. date of deposit)

Reason: Under Ind AS 21, monetary items are units of currency held and assets and liabilities to be received or paid in a fixed or determinable number of units of currency. At the end of each reporting period foreign currency monetary items shall be translated using the closing rate.

The deposit of INR 40 lakhs on 1 October 20X4 represents a prepayment of the cost of chemical and will consequently be accounted for as a non-monetary item. Therefore, RISHI Limited will not retranslate the foreign currency deposit at the balance sheet date ie. 31 December 20X4. RISHI Limited will recognise the balance trade payable at the point of delivery (which falls after the year-end).

2. (a) Yes–Managerial remuneration is within the prescribed limits

Reason:

	Rounded to nearest INR lakhs	
Profit before tax – as per Statement of Profit and Loss	1,000	
Add: Salary paid and recognised in the Statement of Profit and Loss	100	
Add: ESOP expense recognised in the Statement of Profit and Loss *[7,000 ESOP X INR 100 (i.e. grant date fair value)] + [3,000 ESOP X INR 100 (i.e. grant date fair value)/ 2 (i.e. vesting period)]**	9	
Less: Unrealised gain**	(10)	

Net profit under section 198 of the Companies Act, 2013	1,099	
Maximum limit under section 198 of the Companies Act, 2013 - (11% of above net profits)		*121*
Salary paid and recognised in the Statement of Profit and Loss	100	
Add: Value of ESOP determined as perquisite under Income Tax Act, 1961*[7,000 ESOP X INR 150 (i.e. exercise date fair value)]*	11	
*Managerial Remuneration as per Section 2(78)*** of Companies Act, 2013*		*111*
Managerial remuneration exceeds the prescribed limit		*No*

* Ind AS 102 requires ESOP cost is recognised at grant date fair value over the vesting period

** Unrealised gain to be reduced as per Section 198(3)(f) of Companies Act, 2013.

*** Under section 2(78) of Companies Act, 2013 remuneration means any money or its equivalent given or passed to any person for services rendered by him and includes perquisites as defined under the Income-tax Act, 1961.

3. (c) No. Non-reduction of purchase consideration indicate that the purpose and effect of the transaction benefit Riddhi - a key managerial personnel of RISI Limited. Thus, any transaction with SIRI LLP would qualify as a related party transaction under SEBI Listing Regulations.

Reason: Under Regulation 2(1)(zc)(ii) of SEBI (LODR) Regulations, 2015 related party transaction means a transaction involving a transfer of resources, services or obligations between a listed entity or any of its subsidiaries on one hand, and any other person or entity on the other hand, the purpose and effect of which is to benefit a related party of the listed entity or any of its subsidiaries, with effect from April 1, 2023 regardless of whether a price is charged and a “transaction” with a related party shall be construed to include a single transaction or a group of transactions in a contract.

In the extant case the purchase of raw material is routed through entities with seemingly unrelated parties (unrelated party introduced as a subterfuge).

4. **(b)** Yes. Prior approval of the Audit Committee is required. Since the aggregate transactions exceed the qualifying threshold of INR 1,000 crores, prior approval of shareholder is also required.

Reason: Regulation 23(2) of SEBI (LODR) Regulation, 2015 interalia prescribe that "All related party transactions [and subsequent material modifications] shall require prior approval of the audit committee "

Regulation 23(4) of SEBI Listing Regulation interalia prescribe that "All *material related party transactions [and subsequent material modifications as defined by the audit committee under sub-regulation (2)*] shall require [prior] approval of the shareholders through resolution……"

** A transaction with a related party shall be considered material, if the transaction(s) to be entered into individually or taken together with previous transactions during a financial year, exceeds rupees one thousand crore or ten per cent of the annual consolidated turnover of the listed entity as per the last audited financial statements of the listed entity, whichever is lower.*

5. **(b)** ii, iii

Reason: RISI Limited's core strategy spins around providing high-quality, affordable healthcare. This strategy has led to a ***flat fee structure***, making healthcare accessible to a broader population in Assam. However, there's an emerging need to cater to newer generations ***willing to pay a premium*** for better healthcare experiences.

The company should consider **updating its mission and strategic objectives to incorporate profitability, innovation, and ethical practices**.

Unsuccessful efforts in establishing strategic alliance highlight the requirement for a **revamped strategy in forming alliances and collaborations**. Considering new joint ventures or strategic alliances with a more organized approach ***may improve both profitability and service offerings***.

II. Answers to the Descriptive Questions

6. Paragraph B24 of Ind AS 116 provides that a customer has the right to direct the use of an identified asset throughout the period of use if the customer has the right to direct how and for what purpose the asset is used throughout the period of use.

Paragraph B30 of Ind AS 116 states that a contract may include terms and conditions designed to protect the supplier's interest in the asset – generally known as protective rights. Protective rights typically define the scope of the customer's right of use but do not, in isolation, prevent the customer from having the right to direct the use of an asset. For example, a contract may include following protective rights:

- Specify the maximum amount of use of an asset or limit where or when the customer can use the asset,
- Require a customer to follow particular operating practices, or
- Require a customer to inform the supplier of changes in how an asset will be used.

In the given case, RISHI Limited has the right to direct the use of the ambulance van throughout the period of use as it has the right to direct how and for what purpose the truck is used, i.e., whether or when it is used and what it is used for throughout the period of use. The contractual limitations are meant to protect the interest of Vahan Chalak and hence are protective rights. RISHI Limited has the right to direct the use of the asset as prescribed under Ind AS 116.

7.

McKinsey factor	Recommendation
Shared values	1. Clear mission, vision and values are to be determined according to the existing requirements. In doing so all stakeholder groups should be identified, as well as their particular needs and performance expectations. 2. Senior management must constantly re-iterate the importance of values and beliefs to employees. 3. Innovation and creativeness are encouraged e.g. rewards for change, calculated risk-taking.
Strategies	1. RISI Limited's core strategy spins around providing high-quality, affordable healthcare. This strategy has led to a flat fee structure. 2. There's an emerging need to cater to newer generations willing to pay a premium. 3. Alternative fee structures can create new opportunities and in so doing acquire potential new clients. 4. Improve the competitive position e.g. Creation of alliances and partnerships and business requirements analysis.

McKinsey factor	Recommendation
	5. Requirement for a revamped strategy in forming alliances and collaborations. 6. Should strive towards a greater market share buy venturing to other states. 7. Strategies should be responsive to changes in market dynamics.
Skills	1. The organization has made significant investments in training and development. 2. By introducing gender diversity programs, the company can retain its talented female professionals. 3. Performance measurement criteria should be reassessed in light of the relevant business environment. 4. Appraisal must be done more engaging and according to a disciplined approach – rather than a form filling exercise. 5. Perhaps reward system and job enrichment and enlargement should be considered to provide growth opportunities.
Systems	1. Silo approach breed inefficiencies. Integration of departmental systems and main system decision making at organisation level is key for real time data analysis and improved decision making. 2. Integration of systems will free up resources which can be mobilised in other functions. 3. The Company should quickly analyse the benefits that would accrue to the Company from the latest systems. It should also consider the underlying risk such as accuracy and reliability of results generated from these systems.
Structures	1. The organization functions with a multi-divisional framework, which is segregated into Strategic Business Units (SBUs). 2. A core process view of the organisation should be carried out to align the objective of the entity with the SBUs. 3. Move from silo approach to an integrated structure where common functions are shared between SBUs. 4. Provide a basis where authorities and responsibilities are identified that is consistent.
Style	1. Current management style relies on a conventional method for performance evaluations (appraisals).

McKinsey factor	Recommendation
	2. Data and information driven organisation should be promoted. 3. Continuous improvement based on valid measurement of regular processes and services should be promoted. 4. Should continue to leverage technology.
Staff	1. Gender ratio at middle and top level should be improved. 2. Establish enablers to reduce exit of female professionals e.g. crèche facilities. 3. Connect with alumni are not limited to a meeting exercise; but should be leveraged to identify potential boomerang employees.

CASE STUDY 38

BASP & Co. Chartered Accountants are a firm of Chartered Accountants, having offices across major towns of South India. They provide consultancy in the field of GST, income-tax and corporate law. ABC Private Ltd is one of major clients of the firm having a dynamic and professional finance team., Tan & Kan, the Partners of BASP & Co, had regular meetings with Jay, the Director (Finance) of ABC Private Ltd and his team. During one of the meetings, Jay seemed to have quite some points for discussion with Tan & Kan. Having seen new members in the audit team, Jay gave a quick overview about the Company and its operations for their understanding. He explained that the Company manufactures and supplies air conditioners (AC), refrigerators, and other products.

He went on to explain the following points:

(A) The Company is expanding its business and establishing a new unit with an estimated budget of ₹ 250 lakh. The break-up of this expenditure is as follows:

Civil construction ₹ 120 lakh (excluding GST)

Plant and Machinery ₹ 130 lakh (excluding GST)

The civil construction cost of ₹ 120 lakh above includes construction of foundation for installation of Plant and Machinery. The cost of construction of foundation is ₹ 20 lakh. CGST and SGST for both civil construction and Plant and Machinery is 9% each i.e.18% in aggregate. The details of expenditure are as under:

Date	Details	Amount ₹ lakh
1st April 2023	Advance given for Plant & Machinery	40
	Advance to contractor for civil construction	10
15th April 2023	Work of construction begins	
30th April 2023	Civil construction work expenses	25
31st July 2023	Civil construction work expenses	25
1st October 2023	Payment made to suppliers of Plant and Machinery and delivery received	90

31st December 2023	Construction work expenses	20
31st March 2024	Final payment made (including outstanding GST)	40

(B) During the financial year 2023-24, in one of the Board meetings, the management sought an approval from the Board, for investing in equity shares of other Companies as per the provisions of the Companies Act, 2013. The Board approved the management's proposal, after due deliberations and discussions. The Company purchased 10,000 shares of Milaan Ltd. on 1st January 2023 at a price of ₹ 20 per share. Milaan Ltd. declared bonus of one share for every 2 shares held on 31st March 2023 as record date for issue of bonus. The Company sold 10,000 shares purchased on 1st January 2023 on 31st August 2023 at ₹ 15 per share.

(C) In addition to manufacture and supply of ACs, the Company also does installation for the same. It had received advance of ₹5 lakh for supply of 5 split air-conditioners to Bavana Ltd. for installation at their factory in Haryana on 15thFebruary 2024. The Company supplied the ACs and installed them on 28thFebruary 2024 and issued the invoice on the same date i.e. 28th February 2024. The supply was chargeable to tax@ 18% but was reduced to 12% from 25th February 2024. The Company charged GST @ 18% while the buyer Bavana Ltd. contended that GST should have been charged @ 12% as the supply was made after the change of rate.

(D) The Company had entered into an agreement with Hum log Enterprises, a Goods Transport Agency, a proprietorship concern not registered under GST for receiving transportation services by road for carriage of air-conditioners to various parts of country. The said concern has a fleet of 50 vehicles for meeting requirements of its customers. During year 2023-24, company has made payment of around Rs. 50 lakh to Hum log Enterprises on account of above said services availed.

(E) Jay was happy to inform that the Company's operations were going on smoothly and they were on a growth trajectory. During the financial year 2022-23, the Company had a turnover of ₹ 100 Crores and there was Loan outstanding from a bank of ₹ 75 Crores and deposits of ₹ 30 Crores.

(F) After the audit discussions were over, Jay and Kan had a general discussion. During the conversation he mentions that Shahi, a shareholder and non- executive director of the Company has become the present Member of Parliament. His son, Abhir is studying abroad in US. As the present term of Parliament is coming to an end next year, his term also will come to an end. Shahi is willing to contest next election as an

independent candidate. He has many friends and relatives in US and he asked his son to contact them, to collect fund for his election. Jay also told Ranga that Shahi's friend who is a contractor working for Ministry of Transport, Shipping and National Highways also accompanied Shahi on the US trip as part of government delegation.

(G) Jay asked Tan and Kan, if they could help his friend Merun, Partner Mahim& Co, Chartered Accountants. Jay and Merun were close friends and they often used to have professional and academic discussions. Tan and Kan gladly agreed to provide clarifications to Merun, if he had any technical query. Jay set up a zoom call between Merun and them. During the call, Merun said he would be more comfortable and confident, if some other Chartered Accountant reviews the financial statements and audit reports he is signing for purpose of quality control.

I. Multiple Choice Questions

1. Is ABC Private Ltd required to appoint an internal auditor during the financial year 2023-24 for complying with the provisions of Companies Act, 2013?

   (a) The Company is required to appoint internal auditor as one of limits of appointment of internal auditor is met by the company.

   (b) The Company being a private company is not required to appoint internal auditors.

   (c) The Company is not required to appoint the internal auditors, as the appointment of internal auditor is a matter of Board's decision.

   (d) The Company is not required to appoint internal auditor because the thresholds prescribed under the Act, have not been met.

2. The Company will treat the loss on sale of shares as:

   (a) Loss of ₹ 50,000 on sale of 10,000 shares will be claimed as a loss.

   (b) There will be gain of ₹ 16,666.67 as the cost of shares will be spread across total 15,000 shares.

   (c) The Company cannot claim the loss of ₹ 50,000. However, this loss of ₹ 50,000 will become cost of acquisition of remaining 5,000 shares received as bonus.

   (d) Loss of ₹ 50,000 cannot be claimed as loss and the cost of acquisition of bonus shares will be 'nil'.

3. In the background of the facts given above, the amount which ABC Private Ltd. is entitled to take credit for Input tax (ITC) of

   (a) ₹ 45 lakh

   (b) ₹ 27 lakh

   (c) ₹ 23.40 lakh

   (d) ₹ 21.60 lakh

4. Advise ABC Private Ltd, what is the correct position of law based upon the facts given in case study:

   (a) Since payment was received prior to change of rate of tax, old rate will be applicable.

   (b) Since provision of supply and issue of invoice is after the change in rate of tax, and only payment has been received before the change in rate, new rate shall be applicable.

   (c) Since the time of supply shall be earlier of date of receipt of payment and date of issue of invoice, old rate shall be applicable.

   (d) Since provision of service is after the change in rate of tax, new rate shall be applicable. Date of invoice is not relevant.

5. As regards discussion of Tan and Kan with Merun arranged by Jay, which of the following is most appropriate description of Engagement Quality Control Reviewer (EQCR) in accordance with professional standards?

   (a) He can be a partner or other person in the firm (member of ICAI) or partner or employee of another firm (member of ICAI) with appropriate experience.

   (b) He can be a partner of the firm or partner of another firm with appropriate experience.

   (c) He can be partner or employee of another firm (member of ICAI) with appropriate experience.

   (d) He can be partner of another firm with appropriate experience.

II. Descriptive Questions

6. Discuss implications under Income tax law and GST law for ABC Limited in respect of payments made by ABC Private Limited to Hum log Enterprises.

7. Jay feels it is not appropriate for Shahi to seek funds for election in such a manner. With reference to the Foreign Contribution (Regulation) Act, 2010, explain who are prohibited from taking any contributions from a foreign source.

8. In background of Merun's discussion with Tan and Kan, answer the following:

   (i) Can the financial statements and audit report signed by Merun be reviewed by some other Chartered Accountant for quality control? Which issues should be addressed by Merun for appointment of such a person?

   (ii) What should be likely contents of such quality control review policy and procedures, if Merun's firm is required to establish such policy?

ANSWERS TO THE CASE STUDY 38

I. Answers to the Multiple Choice Questions

1. (d) The Company is not required to appoint internal auditor because the thresholds prescribed under the Act, have not been met.

Reason: Rule 13 of the Companies (Accounts) Rules 2014

The condition of deposit does not apply to a Private Company.

2. (c) The Company cannot claim the loss of ₹ 50,000. However, this loss of ₹ 50,000 will become cost of acquisition of remaining 5,000 shares received as bonus.

Reason: According to section 94(8) of Income-tax Act, 1961 where (a) any person buys or acquires any securities or units within a period of three months prior to the record date; (b) such person is allotted additional securities or units without any payment on the basis of holding such securities or units on such date; (c) such person sells or transfers all or any of the securities or units referred to in (a) above within a period of nine months after such date, while continuing to hold all or any of the additional securities or units referred to in (b), then –

(i) the loss on sale of original securities or units sold within a period of 9 months after the record date will be ignored for the purpose of computing his income chargeable to tax and

(ii) the amount of such loss so ignored will be deemed to be the cost of purchase or acquisition of the bonus securities or units referred to in (b) above, held by him on the date of such sale or transfer

The Company cannot claim the loss of ₹ 50,000. However, this loss of ₹ 50,000 will become cost of acquisition of remaining 5,000 shares received as bonus.

3. (b) ₹ 27 lakh

Reason:

Section 17(5)(d) of the CGST Act, 2017 blocks ITC on goods and/or services received by a taxable person for construction of an immovable property (other than plant and machinery) on his own account including when such goods and/or services are used in the course or furtherance of business.

Further, the term "plant and machinery" means apparatus, equipment and machinery fixed to earth by foundation or structural support that are used for making outward supply of goods and/or services and includes such foundation or structural support but excludes land, building or other civil structures, telecommunication towers, and pipelines laid outside the factory premises

Input tax credit is available in respect of - Foundation work = ₹ 20 lakh + Plant and Machinery ₹ 130 lakh = 150 lakh @ 18% = 27 lakh

4. (b) Since provision of supply and issue of invoice is after the change in rate of tax, and only payment has been received before the change in rate, new rate shall be applicable.

Reason: Section 14(b)(iii) of the CGST Act, 2017 provides that where the invoice has been issued after the change in rate of tax but the payment is received before the change in rate of tax, the time of supply shall be the date of invoice.

5. (a) He can be a partner or other person in the firm (member of ICAI) or partner or employee of another firm (member of ICAI) with appropriate experience.

Reason: In accordance with SQC 1, Engagement Quality Control Reviewer is a partner, other person in the firm, suitably qualified external person, or a team made up of such individuals, with sufficient and appropriate experience and authority to objectively evaluate, before the report is issued, the significant judgments the engagement team made and the conclusions they reached in formulating the report.

Further, suitably qualified external person means an individual outside the firm with the capabilities and competence to act as an engagement partner, for example a partner or an employee (with appropriate experience) of another firm.

In view of above, option (a) is appropriate description of EQCR.

II. Answers to the Descriptive Questions

6. **Implications under Income tax law:** Under section 194C of Income-tax Act, 1961, any person responsible for paying any sum to any resident for carrying out any work (including supply of labour for carrying out any work) in pursuance of a contract between the contractor and a specified person shall, at the time of credit of such sum to the account of the contractor or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, deduct an amount equal to one per cent where the payment is being made or credit is being given to an individual or a HUF.

In the given scenario, ABC Private Limited has paid a sum of ₹ 50.00 lakh during year 2023-24 on account of transport services under an agreement to Hum log Enterprises, a proprietorship concern. Section 194C also states that meaning of work includes carriage of goods by any mode of transport other than by railways. The payment is beyond threshold limit for deduction of tax under section 194C. Further, Hum log Enterprises has a fleet of 50 vehicles. Therefore, exemption from deduction under section 194(6) does not apply.

Keeping in view above, there is an obligation for ABC Private Limited to deduct tax at source @ 1% on payments made during year 2023.24. The deduction has to be made at time of crediting such sum to account of Hum log Enterprises or at time of payment whichever is earlier.

Implications under GST law

Hum log Enterprises is unregistered tax payer. However, for carriage of goods by road, recipient of service has to pay GST @ 5% .

Therefore, keeping in view above, ABC Private Limited has to pay GST on services availed from transporter @ 5% on bills of Rs.50 lakh raised by transporter during year 2023-24. Further, ABC Limited is also entitled to claim ITC of such tax paid on reverse charge basis.

7. As per **Section 3 of the Foreign Contribution (Regulation) Act** (FCRA),2010, certain prohibitions are imposed on acceptance of foreign contribution.

Following are the categories of persons on whom directly/indirectly prohibitions are imposed on acceptance of foreign contribution:

(1) No foreign contribution shall be accepted by any:

(a) candidate for election;

(b) correspondent, columnist, cartoonist, editor, owner, printer or publisher of a registered newspaper;

(c) public servant, Judge, Government servant or employee of any corporation or any other body controlled or owned by the Government;

(d) member of any Legislature;

(e) political party or office-bearer thereof;

(f) organization of a political nature as may be specified under Section 5(1) by the Central Government;

(g) association or company engaged in the production or broadcast of audio news or audio visual news or current affairs programmes through any mode of mass communication

(h) correspondent or columnist, cartoonist, editor, owner of the association or Company referred to in clause (g).

(2) The Act also prohibits acceptance of foreign contribution by the following persons:

(a) Person, resident in India, and citizen of India resident outside India- shall not accept any foreign contribution, or acquire or agree to acquire any

currency from a foreign source, on behalf of any political party, or any person referred to in (1) above, or both.

(b) Person, resident in India- shall not deliver any currency, whether Indian or foreign, which has been accepted from any foreign source, to any person if he knows or has reasonable cause to believe that such other person intends, or is likely, to deliver such currency to any political party or any person referred to in (1) above, or both.

(c) Citizen of India resident outside India- shall not deliver any currency, whether Indian or foreign, which has been accepted from any foreign source, to—

(i) any political party or any person referred to in (1) above, or both; or

(ii) any other person, if he knows or has reasonable cause to believe that such other person intends, or is likely, to deliver such currency to a political party or to any person referred to (1) above, or both.

In the give case study, Shahi, who is Member of Parliament and willing to contest next election as an independent candidate. He is seeking funds for his election. He asked his son, Abhir to contact his friends and relatives in US to collect funds.

According to Section 3(1)(a) of the Foreign Contribution (Regulation) Act, 2010 provides that no foreign contribution shall be accepted by any candidate for election.

Therefore, Jay was correct that it is not appropriate for Shahi to seek funds for election in such stated manner.

8. (i) As per **SQC 1**, some sole practitioners or small firms may wish to use other firms to facilitate engagement quality control reviews. Accordingly, financial statements and audit report signed by Merun can be reviewed by some other Chartered Accountant.

The firm's policies and procedures should address the appointment of engagement quality control reviewers and establish their eligibility through:

(a) The technical qualifications required to perform the role, including the necessary experience and authority; and

(b) The degree to which an engagement quality control reviewer can be consulted on the engagement without compromising the reviewer's objectivity.

(ii) Engagement Quality Control Review: The firm should establish policies and procedures requiring, for appropriate engagements, an engagement quality control review that provides an objective evaluation of the significant judgments made by the engagement team and the conclusions reached in formulating the report. Such policies and procedures should:

(a) Require an engagement quality control review for all audits of financial statements of listed entities;

(b) Set out criteria against which all other audits and reviews of historical financial information, and other assurance and related services engagements should be evaluated to determine whether an engagement quality control review should be performed; and

(c) Require an engagement quality control review for all engagements meeting the criteria established in compliance with subparagraph (b).

The firm's policies and procedures should require the completion of the engagement quality control review before the report is issued.

The firm should establish policies and procedures setting out:

(a) The nature, timing and extent of an engagement quality control review;

(b) Criteria for the eligibility of engagement quality control reviewers; and

(c) Documentation requirements for an engagement quality control review.

CASE STUDY 39

Yantra Pedasu Ltd. (YPL) is an unlisted public company, incorporated since 2005, engaged in the steel business, with nine directors on its board. There is a company in Singapore named, SYD Pte Ltd. (SPL) in which it acquired 54% stake during financial year 2022-23 and thereby it became its first subsidiary company. Mr. Sunil Verma has been appointed for the second consecutive term of five years as the managing director of YPL. He has a daughter named, Mrs. Sunita, who is residing in Singapore since last 6 years and she was appointed as the director in SPL, during financial year 2023-24, at a monthly remuneration of SGD 60,000 equivalent to ₹ 3 lakhs.

For financial year 2023-24, YPL appointed Chappan & Co. as its statutory auditors in place of its previous auditors. All the formalities as prescribed by section 139 & 140 of the Companies Act, 2013, were complied with by YPL in relation to such appointment. Also, Chappan & Co. made a written communication vide a registered post acknowledgment due to the previous auditor before accepting such appointment.

CA. Kailash Chappan, one of the senior partners of the firm was appointed as the engagement partner by Chappan & Co. on such audit assignment of YPL. While conducting the audit of YPL, CA. Kailash observed that there were certain accounting estimates made in relation to certain items of financial statements that might give rise to significant risks and thereby he performed substantive procedures in accordance with the requirements of SA 330, "The Auditor's Reponses to Assessed Risks".

Further, CA. Kailash determined that there were certain factors that indicated the existence of certain transactions entered into by YPL for which misstatements of lesser amounts than materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements and accordingly, CA. Kailash lowered his materiality level determined for such transactions.

Apart from conducting the audit assignment, Mr. Kailash also used to solve the concerns raised by the accountant of YPL with respect to GST and Income tax matters. One such concern raised by the accountant to him was with respect to ITC availment under GST, which is briefed as under:

'The balance of ITC with YPL after discharging the GST liability for April month was ₹ 60,00,000. The eligible ITC reflected in GSTR-2B with respect to May month of YPL was ₹ 56,00,000 whereas the input tax paid by it on invoices received during the May month was ₹ 75,00,000 and the output tax liability for the month of May was for ₹ 110 lakhs. So, he was not sure about the amount of ITC to be availed for the month of May for which he consulted CA. Kailash and after following his advise, the GST liability for the month of May was discharged by YPL fully through its balance in electronic credit ledger only.

YPL provides donation every year as a part of its CSR activities to a charitable trust named Shiksha Kalyan Trust (SKT) engaged in activities of providing education to poor children. The average net profit of YPL for the past three years was ₹ 88 crore. Accordingly, during current financial year i.e. during F.Y. 2023-24, it made a donation of ₹ 2 crore to SKT as its CSR spend. SPL, its subsidiary company also proposed to make donation to such trust in India during the same financial year. However, SKT's certificate of registration under the Foreign Contribution (Regulation) Act, 2010, would expire on 20th December, 2023 and it had not applied for renewal of certificate before that as the Head accountant believed that they could apply for renewal of registration within one year from the expiry date as per the law and hence pending but the trustees decided to make an application for renewal for certificate sooner so that the trust can accept donation from SPL and the same was done as per the relevant legal provisions.

YPL bought a machinery from Dusham Ltd. for its business for which YPL received a government grant of ₹ 6 lakhs, the details of machinery are as follows:

Particulars	**(₹)**
List price of machinery (exclusive of taxes and discount)	30,00,000
Corrugated Boxes used for packing the equipment (not included in price above)	60,000
Discount @ 2% is offered on the list price of the machine (recorded in the invoice of the machine)	-

As a part of its policy, YPL depreciates all its plant and machinery at 20% per annum on straight-line basis and also it does not claim depreciation on GST component included in the price of plant and machinery.

On 24th January, 2024, YPL supplied 2000 MT steel pipes to SPL @ ₹ 1 lakh/ MT on CIF basis. Insurance and Freight of ₹ 11,000/ MT were included in it. Also, on 5th February, 2024, it made a supply of 3000 MT steel pipes to another Singapore based company, Unno Pte Ltd. (UPL) @ ₹ 95,000 / MT on FOB basis for which payment was to be made of SGD 5,70,00,000 in 3 months and so in order to protect itself from exchange rate fluctuations., YPL hedged receipt of such foreign currency in the forward market.

I. Multiple Choice Questions

(Provide the correct option to the following questions)

1. What amount of additional tax needs to be paid by YPL if it does not want to repatriate the excess money with respect to supply of steel pipes to SPL?

   (a) ₹ 22,46,400

   (b) ₹ 25,15,970

(c) ₹ 31,20,000

(d) No need to pay additional tax as the amount of primary adjustment does not exceed the prescribed limit.

2. Whether any formalities would have been complied by YPL with respect to appointment of Mrs. Sunita as a director in SPL?

(a) No, as such appointment did not amount to appointment of Mrs. Sunita to an office or place of profit in SPL.

(b) Yes, as Mrs. Sunita was a related party to YPL and she would be drawing a monthly remuneration exceeding ₹ 2.5 lakhs in its subsidiary company.

(c) No, as even though Mrs. Sunita was a related party to YPL but she would be drawing remuneration from SPL, its subsidiary company and not YPL, itself.

(d) No, as such provisions with respect to related party are not applicable in relation to a foreign subsidiary company.

3. How much balance in electronic credit ledger would have been available with YPL after discharging its GST liability for May month for which Mr. Kailash was consulted?

(a) ₹ 11,60,000

(b) ₹ 7,10,000

(c) ₹ 8,80,000

(d) ₹ 28,75,000

4. Till what time period, SKT had to make an application for renewal of its certificate so that it might be accepted and the application should have been accompanied with what amount of fees?

(a) Such application needs to be made within 3 months before date of expiry and the total fees payable with such application shall be ₹ 5,000.

(b) Such application needs to be made within 6 months before date of expiry and the total fees payable with such application shall be ₹ 5,000.

(c) Such application needs to be made by 31st March, 2023 and the total fees payable with such application shall be ₹ 1,500.

(d) Such application needs to be made by 20th December, 2024 and the total fees payable with such application shall be ₹ 6,500.

5. What shall be the value of supply for the machinery supplied by Dusham Limited to YPL?

(a) ₹ 30,60,000

(b) ₹ 25,00,000

(c) ₹ 35,00,000

(d) ₹ 30,00,000

II. Descriptive Questions

6. With reference to the accounting estimates that might give rise to significant risks, what Mr. Kailash should have evaluated in addition to performing procedures as per SA 330?

7. What kind of factors might be there that would have indicated existence of certain transactions entered into by YPL for which Mr. Kailash was required to lower his materiality?

8. Show the statement of profit and loss and balance sheet extracts in respect of the grant received by YPL for first year under both the methods as per Ind AS 20?

ANSWERS TO THE CASE STUDY 39

I. Answers to the Multiple Choice Questions

1. (b) ₹ 25,15,970.

Reason: As per section 92CE of the Income-tax Act, 1961, the assessee is required to carry out secondary adjustment where the primary adjustment to transfer price exceeds ₹ 1 crore and primary adjustment is made in respect of A.Y. 2017-18 and onwards. Where, as a result of primary adjustment to the transfer price, there is an increase in the total income of the assessee, the excess money or part thereof which is available with the AE needs to be repatriated.

In a case where the excess money or part thereof has not been repatriated within the prescribed time, the assessee has the option to pay additional income-tax @ **20.9664%** (i.e., tax @ 18% **plus** surcharge @ 12% **plus** cess @ 4%) on such excess money or part thereof, as the case may be.

YPL and SPL are associated enterprise since YPL is the holding company of SPL. As the similar goods were sold by YPL to UPL, an unrelated party, CUP method can be applied for determining the ALP. While applying the Comparable Uncontrolled Price (CUP) method, the price in comparable uncontrolled transaction needs to be adjusted to account for difference, if any, between the international transaction and uncontrolled transaction and the price so adjusted shall be the ALP.

Hence, the ALP of steel pipes would be:

	(₹)
Price per MT of steel pipes to UPL	95,000
Add: Cost of insurance and freight per M.T.	11,000
Arm's length Price per M.T.	1,06,000

Primary adjustment needs to be made to the total income of YPL for P.Y. 2023-24, which shall be 2000 MT × (₹ 1,06,000 - ₹ 1,00,000) = ₹ 1,20,00,000.

Here, the amount of primary adjustment is ₹ 120 lakhs (as calculated above). Accordingly, the amount of additional tax that needs to be paid by YPL would be ₹ 120 lakhs x 20.9664% = ₹ 25,15,970 (rounded off) if it does not want to repatriate the excess money with respect to supply of steel pipes to SPL.

2. (b) Yes, as Mrs. Sunita was a related party to YPL and she would be drawing a monthly remuneration exceeding ₹ 2.5 lakhs in its subsidiary company.

Reason: Section 188 of the Companies Act, 2013, along with Rule 15 of the Companies (Meetings of Board and its Powers) Rules, 2014 contain provisions which regulate 'related party transactions'. Further, Section 2(76) of the Act defines who is a 'related party.

As per Section 2(76), 'related party', with reference to a company, means a director or his relative;

Where the transaction or transactions to be entered into as contract or arrangement is for **appointment to any office or place of profit in the company**, its subsidiary company or associate company at a monthly remuneration **exceeding ₹ 2.5 lakh as mentioned in clause (f) of sub-section (1) of Section 188,** approval by an ordinary resolution is required**.**

The expression "office or place of profit" means any office or place −

(1) **where such office or place is held by a director -** if the director holding it receives from the company anything by way of remuneration over and above the remuneration to which he is entitled as director, by way of salary, fee, commission, perquisites, any rent-free accommodation, or otherwise;

(2) **where such office or place is held by an individual other than a director or by any firm, private company or other body corporate -** if the individual, firm, private company or body corporate holding it receives from the company anything by way of remuneration, salary, fee, commission, perquisites, any rent-free accommodation, or otherwise.

Mrs. Sunita, was the relative of a director of YPL and she was appointed as the director in its subsidiary company, SPL, at a monthly remuneration of ₹ 3 lakhs during F.Y. 2023-24, the remuneration of which she was entitled to as a related party to the director of YPL holding a place of profit in SPL as its director and no information is given that anything over and above such remuneration was paid or to be paid her. Accordingly, such appointment of her would amount to appointment to an office or place of profit in SPL w.r.t. YPL and accordingly, the required formalities would need to be compiled with by YPL with respect to such appointment of Mrs. Sunita as a director in SPL, i.e. this contract shall be entered into with the prior approval of the company (YPL) by passing an ordinary resolution.

3 (b) ₹ 7,10,000.

Reason: ITC on all invoices/debit notes which are uploaded by the suppliers in their GSTR-1s can be availed in full. The recipient gets details of tax invoices and debit notes uploaded by the suppliers in their GSTR-1s, in his (recipient's) GSTR-2B.

However, in respect of invoices/debit notes the details of which are not uploaded by the suppliers in their GSTR-1s (and hence cannot be seen in GSTR-2B of the recipient), ITC cannot be availed in terms of Rule 36(4) of CGST Rules, 2017.

The balance of ITC with YPL after discharging the GST liability for April month was ₹ 60,00,000.

The eligible ITC reflected in GSTR-2B with respect to May month of YPL was ₹ 56,00,000 whereas the input tax paid by it on invoices received during the May month was ₹ 75,00,000.

Thus, total ITC available for discharging liability for May month = ₹ 60,00,000 + ₹ 56,00,000 = ₹ 1,16,00,000 and the output tax liability for May month for ₹ 110 lakhs.

As per rule 86B of the CGST Rules, 2017, where the value of taxable supply (other than exempt supply and zero-rated supply) in a month exceeds ₹ 50 lakh, amount available in electronic credit ledger can be utilized only to the extent of 99% of the output tax liability while discharging such tax liability. Balance 1% of the output tax liability needs to be discharged from electronic cash ledger.

So, the balance in electronic credit ledger that would have been available with YPL after discharging its GST liability for May month would be ₹ 1,16,00,000 - ₹ 1,08,90,000 (₹ 1,10,00,000 x 99%) = ₹ 7,10,000

4 (b) Such application needs to be made within 6 months before date of expiry and the total fees payable with such application shall be ₹ 5,000.

Reason: As per the provisions of the FCRA, 2010, if the validity of the certificate of registration of a person has ceased in accordance with the provisions of Rule 12, a fresh request for the grant of a certificate of registration may be made by the person to the Central Government as per the provisions of rule 9.

(1) Period for applying for renewal of certificate: Every person who has been granted a certificate, shall have such certificate renewed within six months before the expiry of the period of the certificate.

(2) Filing of an application to CG: An application for renewal of the certificate of registration shall be made to the Central Government in electronic form in Form FC-3C accompanied with an affidavit executed by each office bearer, key functionary and member in Proforma 'AA' appended to these rules within six months before the date of expiry of the certificate of registration.

Every person seeking renewal of the certificate of registration under section 16 of the Act shall open an FCRA Account and mention details of the account in his application for renewal of registration.

An application made for renewal of the certificate of registration shall be accompanied by a fee of rupees five thousand only, which shall be paid through payment gateway specified by the Central Government.

No person whose certificate of registration has ceased to exist shall either receive or utilise the foreign contribution until the certificate is renewed.

If no application for renewal of registration is received or the application is not accompanied by requisite fee before the expiry of the validity of the certificate of registration, the validity of the certificate of registration shall be deemed to have ceased from the date of completion of the period of five years from the date of the grant of certificate of registration.

SKT's certificate of registration under the FCRA, 2010, was expiring on 20th December, 2023 and they had to apply for renewal of certificate as against what the Head accountant believed. Accordingly, it had to make an application for renewal of its certificate by 20th December, 2023 so that it might be accepted and the application shall be accompanied with fees of ₹ 5,000.

5. (d) ₹ 30,00,000.

Reason: Computation of value of taxable supply for Dusham Ltd.

Particulars	(₹)
List price of equipment (exclusive of taxes and discount)	30,00,000
Add: Corrugated Boxes used for packing the equipment (refer section 15(2)(c) of the CGST Act, 2017)	60,000
Total	30,60,000
Less: Discount @ 2% is offered on the list price of the machine (recorded in the invoice of the machine) (refer section 15(3)(a) of the CGST Act, 2017)	(60,000)
Value of taxable supply	30,00,000

Note: The government grant has been received by YPL, so there will be no impact due to grant on value of taxable supply for Dusham Ltd.

II. Answers to the Descriptive Questions

6. **As per SA 540, 'Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures',** for accounting estimates that give rise to significant risks, in addition to other substantive procedures performed to meet the requirements of SA 330, the auditor shall evaluate the following:

(a) How management has considered alternative assumptions or outcomes, and why it has rejected them, or how management has otherwise addressed estimation uncertainty in making the accounting estimate.

(b) Whether the significant assumptions used by management are reasonable.

(c) Where relevant to the reasonableness of the significant assumptions used by management or the appropriate application of the applicable financial reporting framework, management's intent to carry out specific courses of action and its ability to do so.

In the given instance, Mr. Kailash should have evaluated the aforesaid points, in addition to performing procedures as per SA 330.

7. **As per SA 320, 'Materiality in Planning and Performing an Audit',** factors that may indicate the existence of one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements include the following:

- Whether law, regulations or the applicable financial reporting framework affect users' expectations regarding the measurement or disclosure of certain items (for example, related party transactions, and the remuneration of management and those charged with governance).
- The key disclosures in relation to the industry in which the entity operates (for example, research and development costs for a pharmaceutical company).
- Whether attention is focused on a particular aspect of the entity's business that is separately disclosed in the financial statements (for example, a newly acquired business).

In the given instance, factors, as aforesaid, might be there that would have indicated existence of certain transactions entered into by YPL for which Mr. Kailash was required to lower his materiality as for such transactions, misstatements of lesser amounts than materiality for the financial statements as a whole could also reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

8. (a) When grant is treated as deferred income

Statement of profit and loss – An extract

	(₹)
Depreciation (₹ 30,00,000 x 20%)	6,00,000
Government grant credit (W.N.1)	1,20,000

Balance Sheet - An extract

	(₹)	(₹)
Non-current assets		
Property, plant and equipment	30,00,000	
Less: Accumulated depreciation	(6,00,000)	24,00,000
		????
Non-current liabilities		
Government grant	(4,80,000 - 1,20,000)	3,60,000
Current liabilities		
Government grant		1,20,000
		????

Working Note:

Government grant deferred income account

	(₹)		(₹)
To Profit or loss (6,00,000 × 20%)	1,20,000	By Grant cash received	6,00,000
To Balance c/f	4,80,000		
	6,00,000		6,00,000

(b) When grant is deducted from cost of the asset

Statement of profit and loss – An extract

	(₹)
Depreciation {(₹ 30,00,000 - ₹ 6,00,000) × 20%}	4,80,000

Balance Sheet - An extract

	(₹)	(₹)
Non-current assets		
Property, plant and equipment (30,00,000 – 6,00,000)	24,00,000	
Less: Accumulated depreciation	(4,80,000)	19,20,000

CASE STUDY 40

Established in 2003, RP Ltd. (RPL), based in Tirupur, Tamil Nadu, India, has established a foothold for itself as a prominent manufacturer, wholesaler and exporter of high-quality T-shirts. Recognised as a prestigious export house, RPL takes pride in its brand, "RK," known for its commitment to style, comfort, and ethical manufacturing practices.

RPL boasts a state-of-the-art manufacturing facility equipped with advanced technology and machinery. Their production process adheres to stringent quality control measures, ensuring every "RK" T-shirt is crafted using premium materials and delivers exceptional durability, comfort, and style. The company's dedication to quality has not only earned them the trust and loyalty of their domestic clientele but has also established them as a reliable and sought-after supplier in the international market.

Understanding the evolving preferences of their customers, RPL offers a diverse range of T-shirts. Their product portfolio encompasses a wide variety of styles, colours, and designs, catering to diverse demographics and fashion trends. They prioritise innovation and constantly update their collections, ensuring their brand stays ahead of the curve and caters to the ever-changing needs of the T-shirt market.

Looking ahead, RPL is committed to sustainable growth and expanding its global footprint. They are actively exploring new markets and forging strategic partnerships to broaden their international reach. Additionally, they are implementing eco-friendly practices throughout their operations, prioritising responsible sourcing and sustainable manufacturing processes. With a focus on continuous improvement, innovation, and ethical practices, RPL strives to solidify its position as a leading player in the global T-shirt industry.

On 23rd April, 2023, RPL enters into a contract with JM Ltd. (JML) to sell T-shirts for ₹ 600 per T-shirt. As per the terms of the contract, if JML purchases more than 2,000 T-shirts till March 2024, the price per T-shirt will be retrospectively reduced to ₹ 540 per unit. Till September 2023, RPL sold 190 T-shirts to JML. RPL estimates that JML's purchases by March 2024 will not exceed the required threshold of 2,000 T-shirts.

In October 2023, JML acquires DC Ltd. (DCL) and from October 2023 to December 2023, RPL sells an additional 1,200 T-shirts to JML. Due to these developments, RPL estimates that purchases of JML will exceed the 2,000 T-shirts threshold for the period and therefore, it will be required to retrospectively reduce the price per T-shirt to ₹ 540.

RPL is analyzing a strategic move – the potential acquisition of JML through a merger. This decision is driven by the potential for significant synergy benefits that could propel RPL's growth and market position.

The synergy between the two companies can be multifaceted. Firstly, combining their manufacturing capabilities could lead to economies of scale. Sharing resources and expertise could optimize production processes, potentially reducing costs and increasing overall efficiency. Additionally, a larger production capacity could allow RPL to cater to a broader range of customer demands and potentially enter new markets.

The following data are available:

Company	After-tax earnings	No. of equity shares	Market price per share
RPL	₹ 10 crores	10,00,000	₹ 75
JML	₹ 3 crores	2,50,000	₹ 60

It is proposed that certain changes in the shareholding of JML would be made in case of consolidation with RPL, as per the discussion between the management of the two companies, RPL & JML.

During the course of the audit of RPL, CA Devanshi Bisht is verifying export revenues of the company for the F.Y. 2023-24, with her engagement team.

She has verified transactions entered in “Export Sales” account maintained in accounting software from relevant export invoices. The export sales are being made on payment of IGST, for which a refund is automatically credited in the account of the company after the goods are shipped.

On enquiring from internal audit staff regarding the recognition of export revenues, she is told that export sales are recognised for the year on the basis of “Bills of Lading”. However, she is not convinced with such a response and feels that the same does not appear to be proper. She finds that four export invoices bearing dates in the month of March 2024 having a total value of ₹ 125 lakhs have not been recognized in export revenue on the ground that bills of lading for these invoices were issued in the month of April 2024.

Further, during audit of current year, CA Devanshi had identified that there was a misstatement also in last year pertaining to export revenues of the company and the same is still not corrected. She had issued unmodified audit report in last year.

In respect of its Japanese exports, on 31st March, 2024, RPL has an export exposure of JPY 10,00,000 receivables. Japanese Yen (JPY) is not directly quoted against Indian Rupee.

The current spot rates are:

INR/US $	₹ 62.22
JPY/US$	JPY 102.34

It is estimated that Japanese Yen will depreciate to 124 level and Indian Rupee to depreciate against US $ to ₹ 65.

Forward rates for March 2024 are:

INR/US $	₹ 66.50
JPY/US$	JPY 110.35

CA Devanshi recommended that taking a forward cover in such a situation would be beneficial.

On 31st March, 2024, RPL has an outstanding interest liability of ₹ 1 crore towards loan payable to BFCI Ltd., a public financial institution. On the same date, it issued debentures to BFCI Ltd. in lieu of the outstanding interest and deducted the said interest while computing profits and gains of business of A.Y.2024-25. The Assessing Officer, however, rejected the deduction of interest on loan claimed by RPL.

After the issue of such debentures, the company has a total debt of ₹ 3 crores and surplus funds to the tune of ₹ 5 crores. Further, it has made a gross profit of ₹ 18 crores and incurred indirect expenses of ₹ 4 crores for the financial year.

Based on above case study, answer the following questions: -

I. Multiple Choice Questions

1. With respect to information given if the merger goes through by exchange of equity shares between RPL and JML and the exchange ratio is set according to the current market prices, what is the post merger earnings per share of RPL?

   (a) ₹ 104

   (b) ₹ 108.33

   (c) ₹ 83.33

   (d) ₹ 130

2. With respect to information given, certain adjustments would be required to be made to account for the change in the shareholding of JML in case of consolidation. These adjustments are known as:

   (a) Memorandum adjustments.

   (b) Current period consolidation adjustments.

   (c) Permanent consolidation adjustments.

   (d) Temporary period consolidation adjustments.

3. With respect to information given, guide CA Devanshi on the audit opinion considering the fact that the last year's misstatement pertaining to export revenues has been identified in the current year and unmodified opinion was issued in the last year.

   (a) CA Devanshi should give unmodified opinion, but include other matters paragraph in the audit report as last year's profit is being reflected in reserve and surplus.

   (b) CA Devanshi should seek legal opinion.

   (c) CA Devanshi should express a qualified opinion or adverse opinion in auditor's report of current period financial statements, modified with respect to corresponding figures included therein.

   (d) CA Devanshi should give unmodified opinion, but last period's unmodified opinion should be highlighted in Emphasis of matter paragraph.

4. With respect to information given, comment upon the validity of the action of the Assessing Officer on rejecting the deduction of interest on loan claimed by RPL.

   (a) 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 Assessing Officer is correct.

   (b) 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 Assessing Officer is correct.

   (c) 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 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'.

(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 Assessing Officer is not correct.

5. With respect to information given, calculate the Equity Value of RPL if the applicable EBITDA multiple is 4:

(a) ₹ 53 crores

(b) ₹ 58 crores

(c) ₹ 64 crores

(d) ₹ 74 crores

II. Descriptive Questions

6. With respect to information given, analyse and state how the revenue should be recognised in respect of sale of T-shirts by RPL to JML.

7. With reference to information given, discuss from what sources CA Devanshi can obtain reliable audit evidence in respect of the export revenues particularly for the four export invoices of current year. How can she challenge management's assertion regarding the completeness of export revenues for the F.Y. 2023-24?

8. With respect to information given,

(i) Calculate the expected loss, if the hedging is not done. How the position will change, if the firm takes forward cover?

(ii) If the spot rates on March 31, 2024 are:

INR/US $ = ₹ 66.25

JPY/US $ = JPY 110.85

Is the decision to take forward cover justified?

Note: For cross rate of ₹/¥ round off up to 4 decimal points.

ANSWERS TO THE CASE STUDY 40

I. Answers to the Multiple Choice Questions

1. (b) ₹ 108.33

Reason: The current market price is the basis of exchange of equity shares, in the proposed merger, shareholders of JML will get only 2,00,000 shares in all or 4 shares of RPL for every 5 shares held by them, i.e., = (2,50,000 60)/ 75 = 2,00,000

The total number of shares in RPL will then be 12,00,000 and, ignoring any synergistic effect, the profit will be ₹ 13,00,00,000. The new earning per share (EPS) of RPL will be ₹ 108.33, i.e., ₹ 13,00,00,000/12,00,000.

2. (c) Permanent 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.

3. (c) CA Devanshi should express a qualified opinion or adverse opinion in auditor's report of current period financial statements, modified with respect to corresponding figures included therein.

Reason: SA 710 - Para 12

If the auditor obtains audit evidence that a material misstatement exists in the prior period financial statements on which an unmodified opinion has been previously issued, the auditor shall verify whether the misstatement has been dealt with as required under the applicable financial reporting framework and, if that is not the case, the auditor shall express a qualified opinion or an adverse opinion in the auditor's report on the current period financial statements, modified with respect to the corresponding figures included therein.

Here, CA Devanshi had identified that there was a misstatement last year pertaining to export revenues of the company and the same is still not corrected. Although an unmodified audit report was issued last year by her. In accordance with SA 710, CA Devanshi should modify current period audit report with respect to corresponding figures only.

4. (a) 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 Assessing Officer is correct.

Reason: 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 advance or debenture on any other instrument by which the liability to pay is deferred to a future date, the interest so converted and not "actually paid" shall not be deemed as actual payment, and hence, would not be allowed as deduction.

In this case, since RPL has converted the interest of ₹ 1 crore payable to BFCI 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 loan claimed by RPL while computing its profits and gains of business for A.Y. 2024-25, is correct.

5. (b) ₹ 58 crores

Reason: Equity Value of Company

	(₹ 000)
EBITDA (₹ 18,00,00,0000 - ₹ 4,00,00,000)	140000
EBITDA Multiple	4
Capitalized Value	560000
Less: Debt	(30000)
Add: Surplus Funds	50000
Equity Value	580000 (i.e. ₹ 58 crores)

II. Answers to the Descriptive Questions

6. Paragraph 56 of Ind AS 115 states that an entity shall include in the transaction price some or all of an amount of variable consideration estimated in accordance with paragraph 53 only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved.

Further, paragraph 57 of Ind AS 115 state that in assessing whether it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur once the uncertainty related to the variable consideration is subsequently resolved, an entity shall consider both the likelihood and the magnitude of the revenue reversal.

RPL estimates that the consideration in the above contract is variable. Therefore, in accordance with paragraphs 56 and 57 of Ind AS 115, RPL is required to consider the constraints in estimating variable consideration. RPL determines that it has significant experience with this product and with the purchasing pattern of the JML. Thus, if RPL concludes that it is highly probable that a significant reversal in the cumulative amount of revenue recognised (i.e. ₹ 600 per unit) will not occur when the uncertainty is resolved (i.e. when the total amount of purchases is known), then the RPL will recognise revenue of ₹ 1,14,000 (190 T-shirts x ₹ 600 per T-shirt) for the half year ended 30th September, 2023.

Further, paragraphs 87 and 88 of Ind AS 115 states that after contract inception, the transaction price can change for various reasons, including the resolution of uncertain events or other changes in circumstances that change the amount of consideration to which an entity expects to be entitled in exchange for the promised goods or services.

An entity shall allocate to the performance obligations in the contract any subsequent changes in the transaction price on the same basis as at contract inception.

Consequently, an entity shall not reallocate the transaction price to reflect changes in stand-alone selling prices after contract inception. Amounts allocated to a satisfied performance obligation shall be recognised as revenue, or as a reduction of revenue, in the period in which the transaction price changes.

In accordance with the above, in the month of October 2023, due to change in circumstances on account of JML acquiring DCL and consequential increase in sale of T-shirts to JML, RPL estimates that JML's purchases will exceed the 2,000 T-shirts

threshold till March 2024 for the period and therefore, it will be required to retrospectively reduce the price per T-shirt to ₹ 540.

Consequently, the RPL will recognise revenue of ₹ 6,36,600 for the quarter ended December 2023 which is calculated as follows:

Particulars	Amount in ₹
Sale of 1,200 T-shirts (1,200 T-shirts x ₹ 540 per T-shirt)	6,48,000
Change in transaction price (190 T-shirts x ₹ 60* price reduction) for the reduction of revenue relating to units sold till September 2023	(11,400)
Revenue recognised for the quarter ended December 2023	**6,36,600**

*₹ 600 - ₹540 = ₹ 60

7. She can obtain reliable audit evidence by going through GST returns filed by the company on GST portal and correlating the same with e-way bills. She can obtain audit evidence about how company has reflected its export sales in its GST returns and whether export sales pertaining to four invoices having total value of ₹ 125 lakhs are reflected in such returns.

Further, e-way bills generated on the portal would provide evidence that goods have moved out of the company's premises. The export revenue should have been booked at the time the goods moved out of the company's premises. The company is claiming an IGST refund. The refund is linked to the monthly sales return. This aspect can also be verified. "Bill of Lading" is only a document issued by the carrier to the shipper of goods that goods have been taken on board.

She should challenge and counter management's assertion on the above grounds and point out violations of relevant accounting standards and principles. In this way, she can obtain reliable audit evidence. Highlighting such digital and other evidence, she can challenge management's assertion regarding the completeness of export revenues and point out that export revenues are understated.

8. Since the direct quote for ¥ and ₹ is not available it will be calculated by cross exchange rate as follows:

₹/$ x $/¥ = ₹/¥

62.22/102.34 = 0.6080

Spot rate on date of export 1¥ = ₹ 0.6080

Expected Rate of ¥ for March 2024 = ₹ 0.5242 (₹ 65/¥124)

Forward Rate of ¥ for March 2024 = ₹ 0.6026 (₹ 66.50/¥110.35)

(i) Calculation of expected loss without hedging

Value of export at the time of export (₹ 0.6080 x ¥10,00,000)	₹ 6,08,000
Estimated payment to be received on March 2024 (₹ 0.5242 x ¥10,00,000)	₹ 5,24,200
Loss	₹ 83,800

Hedging of loss under Forward Cover

Value of export at the time of export (₹ 0.6080 x ¥10,00,000)	₹ 6,08,000
Payment to be received under Forward Cover (₹ 0.6026 x ¥10,00,000)	₹ 6,02,600
Loss	₹ 5,400

By taking forward cover loss is reduced to ₹ 54,00

(ii) Actual Rate of ¥ on March 2024 = ₹ 0.5977 (₹ 66.25/¥110.85)

Value of export at the time of export (₹ 0.6080 x ¥10,00,000)	₹ 6,08,000
Estimated payment to be received on March 2024 (₹ 0.5977 x ¥10,00,000)	₹ 5,97,700
Loss	₹ 10,300

The decision to take forward cover is still justified.

CASE STUDY 41

Established as a public sector undertaking (PSU) of Government of India, Bharat Chemicals Pharma Ltd. (BCPL) has served as a cornerstone of the Indian pharmaceutical industry since its inception. Headquartered in Kolar, Karnataka, India, BCPL plays a pivotal role in manufacturing high-purity chemicals crucial for various pharmaceutical applications.

BCPL takes immense pride in its unwavering commitment to quality. Their state-of-the-art manufacturing facilities are equipped with advanced technology and machinery. Stringent quality control measures are implemented throughout the production process, ensuring every batch of chemicals meets the highest standards of purity and consistency. This dedication to quality has not only positioned BCPL as a trusted supplier within the domestic market but has also garnered them recognition as a reliable source for pharmaceutical chemicals on the international stage.

Understanding the critical nature of their products for the pharmaceutical industry, BCPL prioritizes meeting the specific requirements of their clientele. They offer a comprehensive range of chemicals specifically tailored for pharmaceutical applications. These chemicals encompass a diverse spectrum, including active pharmaceutical ingredients (APIs), excipients, and solvents, all crucial for the safe and effective production of life-saving medications.

Looking ahead, BCPL is dedicated to continuous innovation and technological advancements. They actively invest in research and development to refine their manufacturing processes and explore the creation of new, high-purity chemicals catering to the evolving needs of the pharmaceutical industry. Furthermore, BCPL recognizes its social responsibility and strives to implement sustainable practices throughout its operations. Their commitment to a cleaner environment and responsible manufacturing processes ensures a brighter future for the communities they serve.

As part of its business expansion strategy, BCPL is in process of setting up a pharma intermediates business which is at very initial stage. For this purpose, BCPL has acquired on 18th April, 2023, 100% shares of BMD Ltd. (BMDL) that manufactures pharma intermediates. The purchase consideration for the same was by way of a share exchange valued at ₹ 70 crores. The fair value of BMDL's net assets was ₹ 30 crores, but does not include:

(i) A patent owned by BMDL for an established successful intermediate drug that has a remaining life of 16 years. A consultant has estimated the value of this patent to be ₹ 20 crores. However, the outcome of clinical trials for the same are awaited. If the trials are successful, the value of the drug would fetch the estimated ₹ 30 crores.

(ii) BMDL has developed and patented a new drug which has been approved for clinical use. The cost of developing the drug was ₹ 24 crores. Based on early assessment of its sales success, the valuer has estimated its market value at ₹ 40 crores.

(iii) BMDL's manufacturing facilities have received a favourable inspection by a government department. As a result of this, the Company has been granted an exclusive ten-year license to manufacture and distribute a new vaccine. Although the license has no direct cost to the Company, its directors believe that obtaining the license is a valuable asset which assures guaranteed sales and the value for the same is estimated at ₹ 20 crores.

After acquisition of BMDL, BCPL made a gross profit of ₹ 100 crores and incurred Indirect Expenses of ₹ 40 crores.

The market related details are as follows:

Risk Free Rate of Return	4.5%
Market Rate of Return	12%
β of the Company BCPL	0.9.
Number of issued Equity Shares	10 crores

In connection with assessment proceedings under GST, the proper officer issued summons to the senior management official of BCPL, Mr. Raj, after recording a brief of the proceedings in the case file and submitting the same to the officer who had authorized the issuance of such summons in the year 2023-2024.

The assessment order demanded payment of GST of ₹ 20 crores along with interest against which BCPL went for appellate proceedings under GST. The company gets the order in its favour on 15th April, 2024, which resulted into reducing the tax liability as on 31st March, 2024. The financial statements for 2023-24 were approved by the board of directors on 15th May, 2024.

The management has not considered the effect of the transaction as the event is favourable to the company. The company's view is that favourable events after the reporting period should not be considered as it would hamper the realisation concept of accounting.

RK & Associates, an audit firm, has been entrusted with the task of auditing the IT department of BCPL. Mr. Rajesh Das, the engagement partner, will be leading the audit on behalf of RK & Associates. A checklist was handed over to him, which contained many questions such as,

- Are separate user names and passwords assigned to individual users?
- Are periodical changes of passwords ensured?
- Are external (offsite) data backups maintained at a place outside the premises?

Mr. Das assembled his audit team with the necessary expertise in IT auditing, then developed a detailed audit plan, outlining the specific procedures to be performed, the timeline for the audit, and the resources required. Mr. Das explained to his team that in an automated environment, the data

stored and processed in systems can be used to get various insights into the way business operates. This data can be useful for preparation of Management Information System (MIS) reports and electronic dashboards that give a high-level snapshot of business performance. Accordingly, the controls over the IT system of the company are very crucial.

While auditing BCPL's IT department, Mr. Das stumbles upon an intriguing detail. He discovers information regarding a new pharma project recently commissioned near Bengaluru. This project, marked by new technology and a hefty price tag of ₹ 1000 crores, has apparently experienced delays and cost overruns.

This information, though relevant to BCPL's overall operations, falls outside the specific scope of Mr. Das's assigned task - auditing the IT department

For the aforesaid project, BCPL imported machine from US through a vessel named 'Last Sails'. The events relating to its entry into India and the discharge and onward movement and storage of are as follows.

24th June	Vessel entered the Indian territorial waters
25th June	Import manifest was delivered to the customs authorities
27th June	XML Ltd filed bill of entry for the goods
29th June	Entry inwards granted to the vessel

The rate of customs duty on such machinery was increased from 7% to 9% on 28th June.

The details of such import transaction are as follows:

S. No.	Particulars	Amount
1	Cost of the machine at the factory of the exporter	US$ 40,000
2	Transport charges from the factory of exporter to the port for shipment	US$ 2,000
3	Handling charges paid for loading the machine in the ship	US$ 200
4	Buying commission paid by the importer	US$ 200
5	Freight charges from exporting country to India	US$ 4,000
6	Actual insurance charges paid are not ascertainable	---
7	Charges for design and engineering work undertaken for the machine in US	US$ 10,000
8	Unloading and handling charges paid at the place of importation	₹ 3,000
9	Transport charges from Mumbai to Karwar port	₹ 50,000
10	Exchange rate to be considered:1$ = ₹ 80	

I. Multiple Choice Questions

1. What is a key factor contributing to BCPL's strategic positioning within the pharmaceutical industry?

   (a) Lack of innovation in manufacturing processes

   (b) Stringent quality control measures

   (c) Limited range of chemical products

   (d) Reliance solely on domestic market

2. Choose the correct statement with respect to issue of summons to Mr. Raj by the proper officer?

   (a) The officer issuing summons to Mr. Raj should have submitted a report to the officer who had authorized the issuance of such summons and not just a recording a brief of the proceedings in the case file. Further, summons to Mr. Raj should not have been issued at the first instance.

   (b) Summons to Mr. Raj should have been issued at the first instance. Mr. Raj should have been summoned whether or not there are indications in the investigation of his involvement in the decision making process which has led to loss of revenue.

   (c) Summons to Mr. Raj should not have been issued at the first instance. Mr. Raj should have been summoned only when there are indications in the investigation of his involvement in the decision making process which has led to loss of revenue.

   (d) Summons to Mr. Raj should not have been issued at the first instance. However, Mr. Raj can be summoned whether or not there are indications in the investigation of his involvement in the decision making process which has led to loss of revenue

3. Choose the correct option relating to the receipt of the order under GST in the favour of the company?

   (a) Such event is an adjusting event providing evidence of a condition existing at the end of the reporting period. Further, such event though favourable needs to be considered as per the relevant Ind AS.

(b) Such event is a non-adjusting event indicative of conditions that arose after the reporting period. So, the question of considering such event does not arise at all whether it is favourable or unfavourable.

(c) Such event is an adjusting event providing evidence of a condition existing at the end of the reporting period. However, as such event is favourable is not required to be considered as per the relevant Ind AS.

(d) Such event is a non-adjusting event indicative of conditions that arose after the reporting period and also, as it is a favourable event need not to be considered even though it would have been an adjusting event.

4. How does BCPL demonstrate its commitment to sustainable practices in line with its strategic positioning?

(a) By overlooking social responsibility in its operations

(b) Through heavy reliance on harmful manufacturing processes

(c) By investing in research and development for technological advancements

(d) By implementing sustainable practices and ensuring environmental responsibility

5. Referring above, which date would be considered for determining the rate of customs duty payable by BCPL and at what rate it should be payable?

(a) 29th June, customs duty payable @ 9%

(b) 27th June, customs duty payable @ 7%

(c) 29th June, customs duty payable @ 7%

(d) 27th June, customs duty payable @ 9%

II. Descriptive Questions

6. Explain the accounting treatment in respect of the transactions with respect to acquisition of BMDL by BPCL under applicable Ind AS.

7. Being entrusted with the task of auditing the IT department of BCPL, Mr. Rajesh Das, the engagement partner, will be leading the audit on behalf of RK & Associates. Which type of audit of IT department of BCPL is being conducted by Mr. Rajesh? Also distinguish such audit from other audit types by providing reasons for the same.

8. Determine the assessable value of the machinery imported by BCPL.

ANSWERS TO THE CASE STUDY 41

I. Answers to the Multiple Choice Questions

1. (b) Stringent quality control measures

Reason: BCPL's strategic positioning within the pharmaceutical industry is significantly influenced by its commitment to maintaining stringent quality control measures throughout its manufacturing processes. This dedication ensures that every batch of chemicals produced meets the highest standards of purity and consistency, crucial for pharmaceutical applications. By consistently delivering high-quality products, BCPL has established itself as a trusted supplier within both the domestic and international pharmaceutical markets. This strategic emphasis on quality control not only enhances the company's reputation but also differentiates it from competitors and reinforces its position as a reliable source for pharmaceutical chemicals.

2. (c) Summons to Mr. Raj should not have been issued at the first instance. Mr. Raj should have been summoned only when there are indications in the investigation of his involvement in the decision making process which has led to loss of revenue.

Reason: The Central Board of Indirect taxes and Customs (CBIC) in the Department of Revenue, Ministry of Finance has issued guidelines from time to time to ensure that summons provisions are not misused in the field. Some of the important highlights of these guidelines, inter-alia, are given below:

- in all cases, where summons is issued, the officer issuing summons should submit a report or should record a brief of the proceedings in the case file and submit the same to the officer who had authorized the issuance of summons;
- senior management officials such as CEO, CFO, General Managers of a large companies or a Public Sector Undertakings should not generally be issued summons at the first instance. They should be summoned only when there are indications in the investigation of their involvement in the decision making process which has led to loss of revenue.

Here, the proper officer issued summons to the senior management official of PSU, Mr. Raj, after recording a brief of the proceedings in the case file and

submitting the same to the officer who had authorized the issuance of such summons.

3. **(a)** Such event is an adjusting event providing evidence of a condition existing at the end of the reporting period. Further, such event though favourable needs to be considered as per the relevant Ind AS.

Reason: As per Ind AS 10, even favourable events need to be considered. What is important is whether a condition exists as at the end of the reporting period and there is evidence for the same making it is an adjusting event.

Here, BCPL went under appellate proceedings under GST. The company got the order in its favour on 15th April, 2024, which resulted into reducing the tax liability as on 31st March, 2024. The financial statements for 2023-24 were approved by the board of directors on 15th May, 2024. The order was received before approval of financial statements of 2023-2024.

Accordingly, such event is an adjusting event providing evidence of a condition existing at the end of the reporting period. Further, such event though favourable needs to be considered as per the relevant Ind AS.

4. **(d)** By implementing sustainable practices and ensuring environmental responsibility.

5. **(a)** 29th June, customs duty payable @ 9%

Reason: As per Section 15 of the Customs Act, 29th June would be considered for determining the rate of customs duty payable by BCPL and the rate of duty will be 9%, because the bill of entry is deemed to have been filed on the date of entry inward though it was actually filed before the rate of duty increased.

II. Answers to the Descriptive Questions

6. As per para 13 of Ind AS 103 'Business Combination', the acquirer's application of the recognition principle and conditions may result in recognising some assets and liabilities that the acquiree had not previously recognised as assets and liabilities in its financial statements. This may be the case when the asset is developed by the entity internally and charged the related costs to expense.

Based on the above, the company can recognise following intangible assets while determining Goodwill / Gain on Bargain Purchase for the transaction:

(i) **Patent owned by BMDL:** The patent owned will be recognised at fair value by BCPL even though it was not recognised by BMDL in its financial statements. The patent will be amortised over the remaining useful life of the asset i.e. 16 years. Since the company is awaiting the outcome of the trials, the value of the patent cannot be estimated at ₹ 30 crores and the extra ₹ 10 crores should only be disclosed as a Contingent Asset and not recognised.

(ii) **Patent internally developed by BMDL:** As per para 18 of Ind AS 103 'Business Combinations', the acquirer shall measure the identifiable assets acquired and the liabilities assumed at their acquisition date fair values. Since the patent developed has been approved for clinical use, it is an identifiable asset, hence the same will be measured at fair value i.e. ₹ 40 crores on the acquisition date.

(iii) **Grant of Licence to BMDL by the Government:** As regards to the ten-year license, applying para 18 of Ind AS 103, grant asset will be recognised at fair value on the acquisition date by BCPL. On acquisition date, the fair value of the license is ₹ 20 crores. However, since the question does not mention about the fair value of the identifiable liability with respect to grant of license for the acquirer, it is assumed that no conditions with respect to compliance of grant (if any) have been passed to the acquirer. Hence, the fair value of the liability with respect to grant, for acquirer would be nil. Only, the grant asset (license) would be recognised at ₹ 20 crores in the books of acquirer BCPL.

Hence the revised working would be as follows:

	₹
Fair value of net assets of BMDL	30 crores
Add: Patent (20 + 40)	60 crores
Add: License	20 crores
Less: Grant for License	(Nil)
Fair value of total net identifiable assets acquired	110 crores
Less: Purchase Consideration	(70 crores)
Gain on Bargain purchase	7crores

7. The information provided in the case study suggests that RK & Associates is conducting a compliance audit of the IT department of BCPL. A compliance audit "is the independent assessment of whether a given subject matter is in compliance with the applicable criteria." In this case, the subject matter is BCPL's IT department, and the

applicable criteria includes industry regulations, internal IT policies, and data security best practices.

Here's a breakdown of the reasons why a compliance audit is the most suitable option:

Focus on IT Controls: The checklist provided to Mr. Das includes questions about user access controls, password management, and data backups. These elements are all crucial for ensuring compliance with data security regulations and best practices.

Management Information Systems (MIS): Mr. Das emphasizes the importance of controls over IT systems due to the valuable data they store and their role in generating MIS reports. Compliance audits often assess an organization's adherence to data privacy regulations and information security standards.

Distinguishing from Other Audit Types

Comprehensive Audit: This is a broader assessment encompassing all aspects of an organization that whether the undertakings have fulfilled the objectives for which they have been established, whether value-for-money spent has been obtained, whether the targets have been achieved, etc. While a compliance audit might be part of a comprehensive audit, the scenario doesn't suggest such a wide-ranging scope.

Propriety Audit: This type of audit is directed towards an examination of management decisions in sales, purchases, contracts, etc. to see whether these have been taken in the best interests of the undertaking and conform to accepted principles of financial propriety. While IT security breaches could have legal implications, the scenario seems more focused on adherence to established IT controls and regulations.

Financial Audit: This audit primarily assesses the accuracy and fairness of an organization's financial statements. The information provided doesn't indicate a focus on financial transactions or accounting records, which are central to a financial audit.

Conclusion

Considering the emphasis on IT controls, data security, and adhering to relevant criteria, a compliance audit is the most likely type of audit being conducted by RK & Associates on BCPL's IT department. Mr. Das's focus on user access, password management, and data backups aligns perfectly with the objectives of a compliance audit in the IT domain.

8. Computation of assessable value of imported machinery

Particulars	Amount (*US$*)
Price of the machine at the factory of the exporter	40,000
Add: Transport charges up to the port in the country of the exporter [Note 1]	2,000

Handling charges at the port in the country of the exporter [Note 1]	200
Charges for design and engineering work undertaken for the machine in US [Note 2]	10,000
Buying commission [Note 3]	Nil
FOB value	52,200
Add: Freight charges up to India	4,000
Insurance charges @ 1.125% of FOB [Note 4]	587.25
Transport charges from Mumbai to Karwar port [Note 5]	Nil
CIF value	56,787.25
Add: Unloading and handling charges paid at the place of importation [Note 6]	Nil
Assessable value	56,787.25
Assessable value in Indian rupees @ ₹ 80/ per $	**45,42,980**

Notes:

(1) The cost of transport, loading, unloading and handling charges associated with the delivery of the imported goods to the place of importation are includible in the assessable value [Rule 10(2)(a) of the Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 (CVR)].

(2) Design and engineering work undertaken elsewhere than in India and necessary for the production of the imported goods is includible in the assessable value [Rule 10(1)(b)(iv) of the CVR].

(3) Buying commission is not included in the assessable value [Rule 10(1)(a)(i) of the CVR].

(4) If insurance cost is not ascertainable, the same shall be added @ 1.125% of FOB value of the goods [Third proviso to rule 10(2) of the CVR].

(5) Cost of insurance, transport, loading, unloading, handling charges associated with transshipment of imported goods to another customs station in India is not included in the assessable value [Sixth proviso to rule 10(2) of the CVR].

(6) As per rule 10(2) of the CVR, only charges incurred for delivery of goods "to" the place of importation are includible in the transaction value.

The loading, unloading and handling charges associated with the delivery of the imported goods at the place of importation are not to be added to the CIF value of the goods.

CASE STUDY 42

Bound by the strong ties of friendship since childhood, Kushal Dabhoi, Raj Varia, and Kishan Kaneja had their paths diverge after graduation. Raj and Kishan, both armed with their shiny new MBA degrees in Finance, decided to join forces and embark on a business venture. Their shared passion for commerce and international trade led them to establish M/s. RK Enterprises, a partnership firm specializing in the wholesale and export of various goods. Their firm thrived, becoming a successful player in the market, thanks to their combined expertise in finance and their unwavering dedication.

Meanwhile, Kushal, who had always been fascinated by the intricacies of accounting and finance, pursued a different path. He diligently applied himself to his studies and emerged victorious, clearing the prestigious Chartered Accountancy exam in May 2023. This accomplishment marked the beginning of a promising career for Kushal. He leveraged his newly acquired qualifications to establish a Nidhi company.

Driven by a desire to give back to society, Kushal didn't stop there. He also co-founded a charitable trust alongside his brother. This trust focused on social causes close to their hearts, aiming to make a positive impact on their community.

Last year, the firm exported a shipment of goods to a buyer in Japan. These goods were covered by a warranty, which was essentially functionality for a specific period. During the current financial year, a situation arose where the Japanese buyer encountered some issues with the exported goods. As these issues fell within the warranty period, the buyer exercised their rights and returns the goods to the firm for repairs.

The firm reports a net profit of ₹ 60,00,000 before deduction of the following items:

(1) Salary of each partner ₹ 1,00,000 per month payable to two working partners of the firm (as authorized by the deed of partnership).

(2) Depreciation on plant and machinery under section 32 (Computed) ₹ 5,00,000.

(3) Interest on capital @15% per annum (as per the deed of partnership). The amount of capital eligible for interest ₹ 10,00,000.

The firm filed the ITR of A.Y. 2024-25. The following are the particulars furnished for A.Y. 2024-25:

Particulars of total income	₹
As per the return of income furnished u/s 139(1)	50,00,000
Determined under section 143(1)(a)	60,00,000

Assessed under section 143(3)	75,00,000
Reassessed under section 147	95,00,000

Tax audit u/s 44AB of the Income-tax Act, 1961 of the firm was conducted by CA Rajdeep who has received the audit fees of ₹ 1,00,000 on progressive basis for the same for the year ended 31.03.2024. The audit report was, however, signed on 22.05.2024.

CA Kushal thought of setting up a finance business. He discussed his thought process with his Raj and Kishan and decided to start a Nidhi company as this was the most easy and affordable way to start a loan business in India which required only seven members with easy documentation. No approval, whatsoever, was also required from Reserve Bank of India as in the case of other finance companies. Further, the Nidhi company would be able to accept deposits from members and lend to them as well, besides earning periodical interests on loans while its main expenditure would be to pay interests on deposits and establishment charges, etc.

CA Kushal with his other trusted friends, including Raj and Kishan, incorporated a Nidhi company under the name Bhagya Nidhi Ltd., on 28th June, 2023, at Udaipur (Rajasthan). It was duly notified as Nidhi in the Official Gazette. It was mentioned in the Memorandum that as Nidhi, the company would cultivate the habit of thrift and savings amongst its members, receive deposits from and lend to, its members only, for their mutual benefit and it shall comply with Nidhi Rules, 2014.

The authorised capital of the company was ₹ 1,00,00,000 divided into 10,00,000 equity shares of ₹ 10 each and the issued, subscribed and paid-up share capital was ₹ 95,00,000 (9,50,000 equity shares of ₹ 10 each). Keeping in view the sufficiency of profits, the company declared a dividend of ₹ 1 per share for the F.Y. 2023-24.

At the same time, CA Kushal and his brother established the 'Bhagya Sugam Charitable Trust' under section 12AB of the Income-tax Act, 1961. This trust is dedicated to charitable activities and is managed by his brother. The trust's name, 'Bhagya Sugam,' reflects its mission of facilitating a smooth and fortunate journey for those it serves.

The trust provides the following information relating to supply of its services during the first quarter of its establishment:

	₹
Renting of residential dwelling for use as a residence to Mr. Nisarg, an unregistered person	15,00,000
Renting of rooms for devotees (Charges per day ₹ 800)	7,00,000
Renting of kalyanamandapam (Charges per day ₹15,000)	11,00,000
Renting of community halls and open space (Charges per day ₹ 8,000)	9,00,000

Renting of shops for business (Charges per month ₹ 9,000)	6,00,000
Renting of shops for business (Charges per month ₹ 11,000)	8,00,000

I. Multiple Choice Questions

1. Assuming that the underreporting of income is not on account of misreporting and none of the additions or disallowances made in assessment qualifies u/s 270A(6), penalty leviable on M/s. RK Enterprises u/s 270A at the time of assessment would be:

   (a) ₹ 3,12,000

   (b) ₹ 1,56,000

   (c) ₹ 4,68,000

   (d) ₹ 2,34,000

2. Assuming that the underreporting of income is on account of misreporting, penalty leviable on M/s. RK Enterprises under section 270A at the time of reassessment would be:

   (a) ₹ 3,12,000

   (b) ₹ 2,34,000

   (c) ₹ 12,48,000

   (d) ₹ 6,24,000

3. Which of the following category of technological advancement best describe installing passbook update kiosk at branch

   (a) Automation

   (b) Extension

   (c) Transformation

   (d) Revolution

4. Bhagya Nidhi Ltd. declared a dividend of ₹ one per share. What is the maximum amount of dividend it is permitted to declare ? Choose the correct option from those given below:

   (a) Since Bhagya Nidhi Ltd. has declared maximum permitted dividend of Re. one per share, it cannot declare dividend in excess of ₹ one per share.

   (b) Bhagya Nidhi Ltd. can declare maximum permitted dividend of ₹ two per share.

   (c) Bhagya Nidhi Ltd. can declare maximum permitted dividend of ₹ two and fifty paise per share.

   (d) Bhagya Nidhi Ltd. can declare maximum permitted dividend of ₹ three per share.

5. Which of the following conditions are to be satisfied by M/s. RK Enterprises to avail exemption on goods re-imported for repairs?

   (i) M/s. RK Enterprises, at the time of importation, executes a bond.

   (ii) Goods must be re-exported within 6 months or 1 year (if time is extended) of the date of re-importation.

   (iii) In case goods are not repaired, new goods are to be sent by M/s. RK Enterprises, within 6 months

   Choose the most appropriate option.

   (a) (i) and (iii)

   (b) (i), (ii) and (iii)

   (c) (ii) and (iii)

   (d) (i) and (ii)

II. Descriptive Questions

6. Compute:

   (i) Book-profit of the firm under section 40(b) of the Income-tax Act, 1961.

   (ii) Allowable working partner salary for the A.Y. 2024-25 as per section 40(b).

7. Referring to the above case study, comment on receipt of audit fees by CA Rajdeep on progressive basis from the firm.

8., Compute the GST liability of Bhagya Sugam Charitable Trust for the first quarter assuming that the above amounts are exclusive of GST and rate of GST, wherever applicable, is 18%.

   Note: The rooms/ Kalyanamandapam/ halls/ open space/ shops owned by the trust are located within the precincts of a religious place, meant for general public, owned by the trust.

ANSWERS TO THE CASE STUDY 42

I. Answers to the Multiple Choice Questions

1. (d) ₹ 2,34,000

Reason: As per section 270A(3) of the Income-tax Act, 1961, under-reported income would be

Assessed income (-) Income determined under section 143(1)(a) i.e. ₹ 75,00,000 – ₹ 60,00,000 = ₹ 15,00,000

As per section 270A(7) of the Income-tax Act, 1961, penalty in case of under reporting of income would be 50% of tax payable on underreported income = 50% of ₹ 4,68,000 [(₹ 15,00,000×30%)+4%] = **₹ 2,34,000**

2. (c) ₹ 12,48,000

Reason: As per section 270A(3) of the Income-tax Act, 1961, under-reported income would be

Income reassessed or recomputed (-) Income assessed in a preceding order i.e. ₹ 95,00,000 – ₹ 75,00,000 = ₹ 20,00,000

As per section 270A(8) of the Income-tax Act, 1961, penalty in case where under reporting of income results from misreporting of income by any person would be 200% of tax payable on such underreported income = 200% of ₹ 6,24,000 [(₹ 20,00,000×30%)+4%] = **₹ 12,48,000**

3. (a) Automation

Reason: Change in business model on account of technological advancements can be classified into automation, extension or transformation. Automation is the use of technologies for performing any function or process digitally which was earlier performed by humans. Installing passbook updation kiosk is automation.

4. (c) Bhagya Nidhi Ltd. can declare maximum permitted dividend of ₹ two and fifty paise per share.

Reason: As per Rule 18 of the Nidhi Rules, 2014:

A Nidhi shall not declare dividend exceeding twenty five per cent in a financial year.

The issued, subscribed and paid-up share capital of Bhagya Nidhi Ltd. was ₹ 95,00,000 (9,50,000 equity shares of ₹ 10 each) and so, it can declare maximum permitted dividend of ₹ two and fifty paise per share (₹ 10 × 25%) .

5. (d) (i) and (ii)

Reason: As per *Notification No.158/95 Cus. dated 14.11.1995 as amended vide Notification No. 60/2018 Cus dated 11.09.2018:*

Goods manufactured in India and reimported for repairs or for reconditioning other than the specified goods:

(a) Goods must be re-exported within six months (extendable till one year) of the date of re-importation

(b) The Assistant Commissioner/Deputy Commissioner of Customs is satisfied as regards identity of the goods.

(c) The importer at the time of importation executes a bond

Accordingly, (i) and (ii) are correct

II. Answers to the Descriptive Questions

6. (i) As per *Explanation 3* to section 40(b), —book profitll shall mean the net profit as per the profit and loss account for the relevant previous year computed in the manner laid down in Chapter IV-D as increased by the aggregate amount of the remuneration paid or payable to the partners of the firm if the same has been already deducted while computing the net profit.

In the present case, the net profit given is before deduction of depreciation on plant and machinery, interest on capital of partners and salary to the working partners. Therefore, the book profit shall be as follows:

Computation of Book Profit of the firm under section 40(b)

Particulars	₹	₹
Net Profit (before deduction of depreciation, salary and interest)		60,00,000
Less: Depreciation under section 32	5,00,000	
Interest @ 12% p.a. [being the maximum interest allowable as per section 40(b)] (₹ 10,00,000 × 12%)	1,20,000	(6,20,000)
Book Profit		53,80,000

(ii) Salary actually paid to working partners = ₹ 1,00,000 × 2 × 12 = ₹ 24,00,000. As per the provisions of section 40(b)(v), the salary paid to the working partners is allowed subject to the following limits –

On the first ₹ 3,00,000 of book profit or in case of loss	₹ 1,50,000 or 90% of book profit, whichever is more
On the balance of book profit	60% of the balance book profit

Therefore, the maximum allowable working partners 'salary for the A.Y. 2024-25 in this case would be:

Particulars	₹
On the first ₹ 3,00,000 of book profit [(₹ 1,50,000 or 90% of ₹ 3,00,000) whichever is more]	2,70,000
On the balance of book profit [60% of (₹ 53,80,000 - ₹ 3,00,000)]	30,48,000
Maximum allowable partners salary	33,18,000

Hence, allowable working partners salary for the A.Y. 2024-25 as per the provisions of section 40(b)(v) is ₹ 24,00,000, being lower than the maximum allowable salary.

7. As per Chapter X of Council General Guidelines, 2008 a member of the Institute in practice or a partner of a firm in practice or a firm shall not accept appointment as auditor of a concern while indebted to the concern or given any guarantee or provided any security in connection with the indebtedness of any third person to the concern, for limits fixed in the statute and in other cases for amount exceeding ₹ 1,00,000/-.

However, the Research Committee of the ICAI has expressed the opinion that where in accordance with the terms of engagement of auditor by a client, the auditor recovers his fees on a progressive basis as and when a part of the work is done without waiting for the completion of the whole job, he cannot be said to be indebted to the company at any stage.

Conclusion: In the instant case, CA Rajdeep is appointed to conduct a tax audit u/s 44AB of the Income Tax Act, 1961. He has received the audit fees of ₹ 1,00,000 in respect of the tax audit for the year ended 31.3.2024 which is on progressive basis. Therefore, Mr. D will not be held guilty for misconduct.

8. Renting of precincts of a religious place meant for general public, owned/managed by, inter alia, an entity registered as a charitable trust under section 12AA/12AB of the Income-tax Act are exempt from GST vide exemption notification. However, said exemption is not available if:

(i) charges for rented rooms are ₹ 1,000 per day or more;

(ii) charges for rented community halls, Kalyan mandapam, open area are ₹ 10,000 per day or more;

(iii) charges for rented shops are ₹ 10,000 per month or more.

Further, services by way of renting of residential dwelling for use as residence to an unregistered person are also exempt vide exemption notification.

Computation of GST liability of Bhagya Sugam Charitable Trust for Quarter 1

Particulars	Value (₹)	GST @ 18% (₹)
Renting of residential dwelling for use as a residence to Mr. Nisarg, an unregistered person [Exempt vide exemption notification]	15,00,000	Nil
Renting of rooms for devotees (Charges per day ₹ 800) [Exempt since charges per day are below ₹1,000]	7,00,000	Nil
Renting of kalyanamandapam (Charges per day ₹ 15,000) [Taxable since charges per day exceed ₹10,000]	11,00,000	1,98,000
Renting of community halls and open space (Charges per day ₹ 8,000) [Taxable since charges per day exceed ₹10,000]	9,00,000	Nil
Renting of shops for business (Charges per month ₹ 9,000) [Exempt since charges per month are below ₹10,000]	6,00,000	Nil
Renting of shops for business (Charges per month ₹ 11,000) [Taxable since charges per month exceed ₹ 10,000]	8,00,000	1,44,000
Total		3,42,000

CASE STUDY 43

Home Décor Limited operate the brand WallKraft – the country's largest maker of home furnishing items. The Company is the partners of choice for premier home furnishing products around the country. It has evolved beyond wallpapers to provide a whole range of decor categories including bed and bath, blinds, curtains and rugs. The brand enjoys a leadership position in its category, with a strong retail presence throughout the country and with a wide network of multi-brand outlets and e-commerce platform. The production facilities are exemplary in embracing technology and the spirit of re-invention. The Company is listed in the National Stock exchange.

Wallpaper is one of their premium products and is an intricate manufacturing process, involving various phases. A typical paper roll of 65 inch and 6,707 m long is cut into six sub-rolls, each about 21 inch wide and 3,048 m long. Then the reverse side of the wallpaper is coated with PVC (vinyl), with thickness depending on the strippability and durability of paper under production. Next, the paper is sent for surface printing process. In surface printing, impregnated metal rollers with a rubber pattern are used. These are mounted on a single machine. Ink is applied to the surface roller. The ink lays in the rubber pattern sitting above the surface of the roller. Ink is then pressed on to the paper by the roller. Upon successful printing of the wallpaper, it is rolled with a wet cornstarch or wheat starch-based coating. Then it is dried thoroughly before packaging. Residential-use wallpapers are cut down into rolls of 15 yards or 13.71 meters. Commercial-use rolls are packaged in 30, 45 and 60 yards rolls. A run number, printed label, and hanging instructions are placed against each roll before storing them in a warehouse, where they await the final shipment. The entire production process consumes 20,000 litres of water every day. A large quantity of waste is generated everyday which is dumped in a landfill near the residential complex of its workers.

It is clear from the business strategies that the major purpose behind its functioning is to generate profits and all efforts are focused on doing just that. However, the Company stated witnessing a reduction in the key performance indicators like profits, revenue, margins, loss of customers, increase in customer complaints and growing employee dissatisfaction. The Company engaged an external consultation to advise them for continuing leadership position. The consultant advised that the ideology of the Company does not take into consideration the impact its operations have on the environment and the people around. The idea should be that a company is managed in such a way that not only generates the desired profits but also improves people's lives and the well-being of the planet.

The consultant proposed a complete overhaul of the Company's manufacturing process and advised that the Company should commit to measuring their social and environmental impact—in addition to their financial performance—rather than solely focusing on generating profit, or the standard "bottom line". A summary of the observations/ recommendations of the consultant using Triple Bottomline theory is as follows.

Profit

The Company's success most heavily depends on its financial performance, or the profit it generates for shareholders. The Company follows Ind AS for the preparing the financial statements under Companies Act, 2013. Strategic planning initiatives and key business decisions are generally carefully designed to maximize profits while reducing costs and mitigating risk. Now, leading company have discovered that they have the power to use their businesses to effect positive change in the world without hampering financial performance. In many cases, adopting sustainability initiatives has proven to drive business success.

People

Traditionally, the Company have favoured shareholder value as an indicator of success, meaning they strive to generate value for those who own shares of the company. As many companies increasingly embrace sustainability, they've shifted their focus toward creating value for all stakeholders impacted by business decisions, including shareholders, customers, employees, and community members.

Some simple ways companies can make an impact on people—and serve future generations—include ensuring fair hiring practices and encouraging volunteerism in the workplace. They can also look externally to effect change on a larger scale. For instance, many organizations have formed successful strategic partnerships with nonprofit organizations that share a common purpose.

Planet

While businesses have historically been the greatest contributors to climate change, they also hold the keys to driving positive change. The Company should recognize their social responsibility to do so. This effort isn't solely on the shoulders of the country's largest corporations—virtually all businesses have opportunities to make changes that reduce their carbon footprint. Adjustments like using ethically sourced materials, cutting down on energy consumption, and streamlining shipping practices are steps in the right direction toward long-term sustainability.

Basis the above suggestions the CFO decided to make the following changes:

1. At present the Company donate to PM CARE Fund for development for socio-economic development and relief of the Scheduled Castes, the Scheduled Tribes while fulfilling its CSR obligations under the Companies Act, 2013. In addition to donation of the Fund, the Company should allocate a significant portion of the CSR resources to advance human rights and fight poverty and hunger.
2. Commit to 100% organic cotton products. Urge suppliers to help in the development and implementation of greening the supply chain.
3. Employees can leave their jobs for up to two months with continued salary pay and benefits, to intern at an environmental organization of their choice.
4. Removal of unnecessary packaging materials thereby leading saving of 12 tons of packaging materials from ending up in the garbage, while at the same time saving the company INR 15 crores annually.
5. Presently, extended producer responsibility norms do not require the Company to recycle products that have reached the end of its life in a sustainable manner. These norms voluntarily be extended to cover discarded materials ending at landfill.

During the year, a search under section 132 of the Income-tax Act, 1961 was initiated in the business premises of Home Decore Ltd. and cash of INR 89 crores was found in the locker.

On the basis of the findings of the Investigation wing, Assessing Officer issued show cause notice to the Home Décor Limited to justify the cash identified during the search and seizure. In response, Home Décor Limited submitted the details along with few sample invoices relating to sale of old and discarded assets. The Assessing Officer observed that Home Décor Limited did not furnish ledger account of these parties, copies of the agreement, copies of supporting documents, standard operating procedure adopted for sale of old discarded assets and email address of the responsible persons. Therefore, Assessing Officer was of the view that there was substantive evidence that the Company have undisclosed income of INR 89 crores.

The Assessing Officer also asked the latest financial statements of the Company. A summary of key financial information of the Company are as follows:

INR crores

Profit and Loss		
	3 Months ended 30 June 20X4	FY 20X3 – FY 20X4
Revenue	100	893

Balance sheet		
	30 June 20X4	31 March 20X3
Non-current assets	900	1,000

Expenses	80	160
Profit after tax	20	733

Current assets	800	100
Surplus	320	300
Reserves	300	580
Total liabilities	1,080	220

The statutory auditor of the Company is of the view that revenue qualifies as a Key Audit Matter as prescribed in SA 701. Accordingly, following paragraph relating to Key Audit Matter is proposed in the audit report.

Key audit matters are those matters that, in our professional judgment, were of important to the users of the financial statements. These matters were addressed in the context of forming a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context

Important matters	**How our audit addressed the key audit matter**
Revenue recognition The Company derives significant portion of its revenue from sale of home furnishing items. Revenue is recognised when the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.. 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). During the current year the Company has recognised revenue of INR 100 crores on account of retrospective price increase which have not been specifically stated in the financial statements due to its sensitivities.	We have performed the following procedures: ▪ We assessed the appropriateness of the revenue recognition accounting policies by comparing with applicable accounting standards. ▪ We evaluated the design, tested the implementation and operating effectiveness of key internal controls including general IT controls and key IT application controls over recognition of revenue. ▪ Performed substantive testing by selecting samples of revenue transactions recorded during the year by testing the underlying documents which included invoices, good dispatch notes, customer acceptances and shipping documents (as applicable). ▪ We carried out analytical procedures on revenue recognised during the year to identify unusual variances.

Revenue is a critical measure of financial performance that reveals how well a company can generate money from its businesses and includes exercise of significant judgement such as determination of transaction price and recognition of variable consideration. Accordingly, revenue recognition is considered as a Key Audit Matter.	▪ We tested, on a sample basis, specific revenue transactions recorded before and after the financial year end date to determine whether the revenue had been recognised in the appropriate financial period. ▪ We tested manual journal entries posted to revenue to identify unusual items.

I. Multiple Choice Questions

1: The CFO observed that the usage of Triple Bottomline theory would require significant automation. Choose the most appropriate automation process to deal with repetitive tasks?

(a) Optical Character Recognition

(b) Robotic Process Automation

(c) Cloud computing

(d) Enterprise Resource Planning

2. While preparing the financial statements for the year, the management disclosed previous year's income from sale of looms as an exceptional item in the current year. Management's contention was that since amount is very significant and also relate to previous year the transaction would qualify as an exceptional item. Do you agree with the contention of the management?

(a) No. previous year's unrecognised income should have been presented as Other Operating Revenue in the Statement of Profit and Loss.

(b) No. previous year's unrecognised income cannot be disclosed as an exceptional item of the current year due to a specific prohibition under Ind AS 1.

(c) No. previous year's unrecognised income should have been presented as Other Income in the Statement of Profit and Loss.

(d) No. previous year's unrecognised income represents a prior period error and should be recognised in respective periods by restating the comparative information in accordance with Ind AS 8.

3. Pursuant to restatement of comparative information, the auditor is of the view that a material weakness exists in internal controls with reference to financial statements. Accordingly, the audit opinion of the current year on internal controls should be modified. Do you agree with the auditor's conclusion?

(a) Yes –Restatement of comparative information is a strong indicator of material weakness.

(b) Yes– Any lapse in internal controls relating to inventory and revenue is a material weakness.

(c) No – Since accounting treatment as prescribed under Ind AS have been done.

(d) No – Since lapses in internal control relate to previous years; audit opinion is on the current years internal controls and not previous year.

4. Whether the amount of undisclosed income should be reported by the auditor as fraud under CARO 2020?

(a) No. Since CARO 2020 require reporting of fraud committed on the Company by employees.

(b) No. Search and seizure operation has been carried under the provisions of the Income Tax Act, 1961 and hence cannot be reported under the requirements of the Companies Act, 2013.

(c) Yes. Undisclosed income is a fraud since it involve the use of deception to obtain an illegal advantage. Paragraph 3(xi)(a) of CARO 2020 requires reporting of material frauds committed on the Company.

(d) Yes. Undisclosed income is a fraud since it injures the interest of the Company. Paragraph 3(ix)(a) of CARO 2020 requires reporting of all frauds committed on the Company.

5. If during the search proceedings, the Company admits the undisclosed income of INR 89 crores and also provides necessary explanation on how such income is derived and pays necessary amount of tax together with interest and furnishes the return of income declaring such undisclosed income, how much penalty would be leviable in such case?.

(a) No penalty would be leviable.

(b) Penalty @10% of undisclosed income.

(c) Penalty @30% of undisclosed income.

(d) Penalty @50% of undisclosed income.

II. Descriptive Questions

6. Are the Key Audit matters in accordance with SA 701. Give reasons

7. How can the CFO's suggestions be categorized according to TBL framework? Also give justification

ANSWERS TO THE CASE STUDY 43

I. Answers to the Multiple Choice Questions

1. (b) Robotic Process Automation

Reason: Robotic Process Automation (RPA) uses software "robots" to automate high-volume repetitive tasks, freeing up human for more valuable work and strategic work.

2. (d) No. previous year's unrecognised income represents a prior period error and should be recognised in respective periods by restating the comparative information in accordance with Ind AS 8.

Reason: As per para 5 of Ind AS 8

Prior period errors are omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:

(a) was available when financial statements for those periods were approved for issue; and

(b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.

Further, para 42 of Ind AS 8 states that subject to paragraph 43, an entity shall correct material prior period errors retrospectively in the first set of financial statements approved for issue after their discovery by:

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

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

3. (a) Yes –Restatement of comparative information is a strong indicator of material weakness.

Reason: Guidance Note on ICFR: Each of the following is an indicator of a control deficiency that should be regarded as at least a significant deficiency and a strong indicator of a material weakness in internal control:

Restatement of previously issued financial statements to reflect the correction of a material misstatement. (The correction of a misstatement includes misstatements due to error or fraud; it does not include restatements to reflect a change in accounting principle to comply with a new accounting principle or a voluntary change from one generally accepted accounting principle to another generally accepted accounting principle.)

4. **(c)** Yes. Undisclosed income is a fraud since it involve the use of deception to obtain an illegal advantage. Paragraph 3(xi)(a) of CARO 2020 requires reporting of material frauds committed on the Company.

Reason: Paragraph 3(xi)(a) of CARO requires the auditor to report whether any fraud has been noticed or reported either on the company or by the company during the year and is not limited to frauds by the officers or employees of the company. The definition of fraud as per SA 240 and the explanation of fraud as per section 447 of the Companies Act, 2013 are similar, except that under section 447 of the Act, fraud includes 'acts with an intent to injure the interests of the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss.'

5. **(c)** Penalty @30% of undisclosed income.

Reason: Under section 271AAB(1A) of Income-tax Act, 1961 – penalty of 30% of the undisclosed income is levied

II. Answers to the Descriptive Questions

6. **The above paragraph on Key Audit Matters is not appropriate due to the following reasons:**

Observations	Reasons
The description of opening paragraph on Key Audit Matters is incorrect on account of the following: Described as matters of importance to the users of the financial statements. Forming a separate opinion on these matters	Under SA 701, Key audit matters are: Those matters that, in the auditor's professional judgment, were of **most significance** in the audit of the financial statements of the current period. Addressed in the context of the audit of the financial statements as a whole, and in forming the auditor's opinion thereon, and the auditor does not provide a separate opinion on these matters

Observations	Reasons
Heading of the table incorrect	The auditor should include a separate section under the heading "Key Audit Matters"
Reference to where the matter is disclosed in the financial statements not provided	The description of key audit matters is not a mere reiteration of what is disclosed in the financial statements. A reference to any related disclosures enables intended users to further understand how management has addressed the matter in preparing the financial statements.
Description of policy of revenue recognition is incorrect and not in accordance with Ind AS 115.	Under Ind AS 115 revenue is recognised at the point in time when control of the asset is transferred, instead of recognising of revenue on transfer of risk & rewards. Control of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. Control includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset.
Recognition of revenue due to price increase has not been disclosed publicly. Key Audit matter cannot be provided on information that is not made publicly available by the entity. However, the auditor may consider it necessary to include additional information to explain why the matter was considered to be one of most significance in the audit and therefore determined to be a key audit matter, and how the matter was addressed in the audit, provided that disclosure of such information is not precluded by law or regulation.	Original information is any information about the entity that has not otherwise been made publicly available by the entity. Such information is the responsibility of the entity's management and those charged with governance.

Observations	Reasons
All audit procedures (instead of relevant procedures) described	Aspects of the auditor's response or approach that were most relevant to the matter or specific to the assessed risk of material misstatement should be stated. Listing of all procedures is not required.

7.

Suggestion	Category
CSR	**Social equity bottom line** ▪ An organization integrating CSR into their business strategy is good for business.
Use of organic cotton	**Environmental bottom line** ▪ There are many environmental benefits such as non-usage of pesticides and chemicals would positively impact the soil condition thereby improving production, saving of natural resources especially water.
Intern at environmental organisation	**Environmental bottom line** ▪ This offers Company's employees the opportunity to explore, learn, and actively participate in combating environmental issues, including conventional cotton.
Removal of unnecessary packaging materials	**Economic bottom line** ▪ Making changes that are advantageous for the environment is turning out to be economically beneficial for the Company.
Extended producer responsibility.	**Environmental bottom line** ▪ Affects ecological surroundings

CASE STUDY 44

Established in 1971 in Siliguri, West Bengal, HotSip Limited stands as a distinguished Indian company renowned for its expertise in the marketing and retailing of specialty tea products nationwide. With a rich history spanning over several decades, HotSip has emerged as a premier destination for tea enthusiasts seeking high-quality and unique blends.

At the heart of HotSip's operations lies its extensive workforce, comprising approximately 182,000 employees dedicated to delivering exceptional customer experiences. These employees are deployed across a vast network of 19,767 company-operated and licensed stores strategically located across the country. This widespread presence underscores HotSip's commitment to accessibility and customer convenience, ensuring that its diverse range of specialty teas are readily available to consumers across various regions.

Their product mix includes handcrafted high-quality/ premium priced tea, a variety of fresh food items and other beverages. They also sell a variety of tea products and license their trademarks through other channels such as licensed stores and grocery. As a listed entity, the Company adheres to stringent financial reporting standards, particularly those outlined in the Indian Accounting Standards (Ind AS). These standards serve as the guiding framework for the preparation and presentation of the Company's financial statements, ensuring transparency, comparability, and accuracy in financial reporting.

By following Ind AS, the Company upholds a commitment to best practices in accounting and financial disclosure, aligning its reporting practices with internationally recognized norms and standards. This not only enhances the credibility and reliability of the Company's financial statements but also instills confidence among investors, stakeholders, and regulatory authorities.

The core competence of HotSip has been its ability to effectively leverage their cornerstone product differentiation strategies by offering a premium product mix of high quality tea and snacks. HotSip's brand equity is built on selling the finest quality tea and related products, and by providing each customer a unique "HotSip Experience", which is derived from supreme customer service, clean and well-maintained stores that reflect the culture of the communities in which they operate, thereby building a high degree of customer loyalty with a cult following.

HotSip Limited primarily operates and competes in the retail tea and snacks store industry. This industry experienced a major slowdown in the recent past due to the advent of COVID 19 and changing consumer tastes, with the industry revenue declining 6.6% to INR 1,800 crores. Before this, the industry had a decade of growth consistent. Due to the economic disruptions, consumers spent less on luxuries like eating out, choosing to purchase low-price items instead of high-priced tea drinks due to shrinking budgets. The industry grew at a low annualized average growth rate of 0.9% from 20X1 till 20X3 with current industry revenues at INR 1,900

crores. The industry is now forecasted to grow at an annualized rate of 3.9% over the next five years, with a potential to reach INR 3,000 crores revenues. This growth would be mainly driven by an improving economy, increase in consumer confidence and expanding menu offerings within the industry. HotSip dominates the industry with a market share of 46.7%, DrinkTea Brand with 24.6% and other competitors like Donald's tea, HomeTea, etc. taking the rest.

This industry is in a mature stage with a medium level concentration. HotSip and DrinkTea make up more than 60% of the market share, giving them considerable market power in determining industry trends. The industry's demand for premium tea and snack products are mainly driven by a number of factors which include disposable income, per capita tea consumption, attitudes towards health, world pricing of tea and demographics. This industry is highly sensitive to the macroeconomic factors that affect the growth in household disposable. During the economic disruption, the decline in household disposable income due to increased unemployment and stagnant wages, caused a downward pressure on the revenue and profitability margins in the industry. Another crucial factor for analyzing the demand in the industry is the per capita tea consumption where the increase in tea consumption increases the revenue of team and snack shops. The main driver of this consumption increase would be the increase disposable income, as the economy improves, and consumers start to relax their budgets. This driver has a positive effect on market revenue. Per capita tea consumption is expected to increase in 20X4.

As tea leaves are the primary input in the value chain of the industry participants, the prevailing volatile prices of tea leaves determines market costs and profitability margins. The world price of tea has risen sharply in recent years due to growing demand in other countries and the resulting supply shortages. During the next five years, tea leaves prices are projected to decrease, which will likely translate into lower market costs and higher profitability. Attitudes towards health also play an important role in determining the demand in the industry. There is an expected shift towards healthy eating and diet among the consumers in 2014, and this could be a potential threat to the industry as they become more aware of issues related to weight and obesity. There has been a proactive shift among the industry participants to tailor their menus towards more organic and healthy products mix.

HotSip Limited is planning to engage a firm as a consultant to analyse the retail tea and snacks industry using Porter's five forces. HotSip Limited, a company specializing in beverages, is in the process of considering hiring an external consulting firm to conduct a thorough examination of the retail tea and snacks industry. The purpose of this analysis is to gain valuable insights into the competitive dynamics and market forces shaping the industry landscape. Specifically, HotSip Limited aims to leverage Porter's renowned five forces framework as a systematic approach to assess the industry's competitiveness and identify key factors influencing its profitability and sustainability. This strategic initiative reflects HotSip

Limited's commitment to informed decision-making and proactive management of its business operations within the dynamic and evolving retail tea and snacks sector.

HotSip Limited, a prominent player in the beverage industry, embarked on a strategic journey to bolster its brand presence in the Southern state of Kerala. Recognizing the potential of this market and the need for a comprehensive approach to expansion, HotSip formulated plans to merge one of its subsidiary companies, HotBrew Limited. For HotBrew Limited, the merger provides a pathway to enhanced resources and market access through its affiliation with HotSip. As a subsidiary of HotSip, HotBrew stands to benefit from the parent company's scale, expertise, and brand reputation, positioning it for accelerated growth and market leadership in the competitive beverage industry. By keeping stakeholders informed and engaged throughout the process, HotSip can foster trust and confidence in its strategic direction, laying the foundation for long-term success and value creation.The merger proposal was carefully crafted in adherence to the regulatory framework outlined in the Companies Act of 2013, which provides a structured mechanism for corporate mergers and acquisitions in India. Under this scheme, HotBrew Limited, with its distinct portfolio and operations, would be seamlessly integrated into the parent company, HotSip Limited. HotBrew Limited boasted a significant amount of internally generated intangible assets that were still in the developmental phase. These assets, ranging from proprietary recipes to brand concepts, represented valuable intellectual property critical to the company's long-term success. However, as per the proposed merger scheme, it was determined that these intangible assets would be written off by debiting reserves and surplus of HotSip post-merger.

The Company has a centralised treasury department that arranges funds for all the requirements of the company including funds for working capital and expansion programs. During the year ended 31st March 2024, the company added further cost while constructing Plant 1 (out of general borrowings) and started construction of Plant 2 (out of specific borrowing). Both Plant 1 and Plat 2 are under construction. HotSip incurred interest of INR 15 lakhs (including interest on specific borrowing of INR 5 lakhs) during the previous year 2023-24. Total assets (other than those funded out of specific borrowings) at the beginning of the year were INR 500 lakhs and at the end of the year were INR 800 lakhs. Other the necessary details are as follows:

INR lakhs

Particulars	Plant 1	Plant 2
Balance of capitalised amount at the beginning of the year	20	-
Cost incurred during the P.Y. 2023-24	80	10
Balance of capitalised amount at the end of the year	100	60

I. Multiple Choice Questions

1. The management of HotSip Limited plans to use the analysis from Porters Five Forces in isolation. Select the correct statement?

   (a) No. The analysis is a good starting point, but should not be used in isolation. May be combined with STEEPLE analysis.

   (b) Yes. The analysis is a good starting point, but can be used in isolation. Use of STEEPLE analysis is inappropriate.

   (c) No. The analysis is a good starting point, but should not be used in isolation. Use of STEEPLE analysis is inappropriate.

   (d) Yes. The analysis is a good starting point, but can be used in isolation. Use of STEEPLE analysis is appropriate.

2. Following relevant information is available:

INR Lakhs

	HotSip Limited	HotBrew Limited
Net profit	80	24
No of equity shares (lakhs)	16	4
Market Value per share (INR)	100	90

HotBrew Limited wants to ensure that earnings available to its shareholders are not reduced post merger. What should be the exchange ratio in that case?

   (a) Exchange ratio of 1:9

   (b) Exchange ratio of 6:5

   (c) Exchange ratio of 3:1

   (d) Exchange ratio of 1:1

3. The Company secretary was drafting the Board Resolutions for the upcoming Board Meeting. It appeared to the Company Secretary that the merger of HotBrew would qualify as a related party transaction under section 188 of the Companies Act, 2013 as it would involve transfer of assets and liabilities from a subsidiary company. Should the Company Secretary draft Board Resolution to ensure compliance with Section 188?

   (a) No. Mergers are not covered under Section 188 of the Companies Act, 2013.

   (b) Yes. Section 188 of the Companies Act, 2013 covers buying of assets.

   (c) No. Transactions in ordinary course of business and on an arm's length are excluded from Section 188.

(d) Yes. The Company should also obtain approval of members, if the qualifying conditions are met

4. The Scheme of merger of HotBrew was approved by NCLT after the year end and was filed immediately with the Registrar of Companies. Which of the following statements would be true?

(a) Account for the merger in the next financial year since the scheme was approved after the year end.

(b) Account for the merger in the current financial year since Board approval is sufficient and rejection by NCLT is unlikely in case of merger of a subsidiary.

(c) Account for the merger in the next financial year since the scheme would be filed with Registrar of Companies after the year end.

(d) Account for the merger in the current financial year since the approval of scheme by NCLT is an adjusting event.

5. The auditor of the Company is specifically concerned with the accounting treatment in respect of write off of internally generated intangible assets. He is in a dilemma whether to modify the audit opinion since the accounting treatment is not in conformity with Ind AS. On the other hand, it is also widely understood that legal provisions have primacy over the requirements of Ind AS. What is the correct course of action that auditor should consider in such situation?

(a) He should consider issuing an adverse opinion – since the accounting treatment is not in accordance with Ind AS.

(b) He should give unmodified opinion and include an Emphasis of Matter paragraph in the audit report if the effect is material.

(c) He should give unmodified opinion (no Emphasis of Matter paragraph) in all cases– since the Schedule III to the Companies Act, 2013 requires specific disclosures.

(d) He should withdraw from the engagement – as this imposes a significant scope limitation for the auditor.

II. Descriptive Questions

6. The Finance manager was computing the interest to be capitalised as per ICDS – IX. As per the finance manager, borrowing cost of INR 1 lakhs and INR 2 lakhs should be capitalised for Plant 1 and Plant 2, respectively. Do you agree?

7. You are required to analyse the retail tea and snacks industry using Porter's five forces.

ANSWERS TO THE CASE STUDY 44

I. Answers to the Multiple Choice Questions

1. (a) No. The analysis is a good starting point, but should not be used in isolation. May be combined with STEEPLE analysis.

Reason: Porter's Five Forces is a good starting point to evaluate an industry but should not be used in isolation. You could, for example, combine it with a Value Chain Analysis or through the VRIO framework in order to get a better sense of where your company's competitive advantage is coming from and to better position your company among rivals. Moreover, Porter's Five Forces is often combined with the STEEPLE analysis to give a good overview of the organization's environment.

2. (b) Exchange ratio of 1:9

Reason: **INR Lakhs**

	HotSip	HotBrew
Current EPS	5 (INR 80 lakhs/ 16 lakhs shares)	6 (INR 24 lakhs/ 4 lakhs shares)
Exchange ratio	-	1.2 (6/5)
No of shares to be issued	4,80,000 (4 lakhs shares X 1.2 i.e exchange ratio)	-
Total no of shares of the Company	20.80 Lakhs (16 lakhs + 4.80 lakhs)	-
EPS after merger	5 (INR 104 lakhs i.e combined earnings/ 20.80 lakhs i.e total no of shares)	-

3. (a) MCA on17 July 2014 have clarified that:

Reason: Transactions arising out of Compromises, Arrangements and Amalgamations dealt with under specific provisions of the Companies Act, 1956/Companies Act, 2013, will not attract the requirements of section 188 of the Companies Act, 2013.

4. **(d)** Account for the merger in the current financial year since the approval of scheme by NCLT is an adjusting event.

Reason: In the financial statements assets should be recognised when an entity is able to exercise control. Approval of merger scheme is a substantive condition to demonstrate control. The approval is also a pre-requisite for giving effect to a scheme of merger in the financial statements of the Company. Approval of Scheme of merger is accorded after the year-end provide further evidence of conditions existing on the balance sheet date and would hence to be an adjusting event under Ind AS 10. Accordingly Scheme of merger with HotBrew should be recognised in the current financial year since HotBrew is already controlled by the Company. Approval of Scheme by NCLT is an adjusting event and hence should be recognised in the financial statements of the current year.

5. **(b)** He should give unmodified opinion and include an Emphasis of Matter paragraph in the audit report if the effect is material.

Reason: In this situation, the departure is not a non-compliance with the accounting framework but compliance with a modified framework. If the effect of doing this is material, the auditor should describe the resultant deviation from the framework in sufficient detail in an Emphasis of Matter Paragraph as provided by SA 706:

A4. Appendix 1 identifies SAs that contain specific requirements for the auditor to include Emphasis of Matter paragraphs in the auditor's report in certain circumstances. These circumstances include:

- When a financial reporting framework prescribed by law or regulation would be unacceptable but for the fact that it is prescribed by law or regulation.

II. Answers to the Descriptive Questions

6. The Central Government has notified ten Income Computation and Disclosure Standards (ICDSs), to be followed by all assessees (other than individual or a HUF who is not required to get his accounts of the previous year audited in accordance with the provisions of Section 44AB of the Income-tax Act, 1961) following the mercantile system of accounting for the purpose of computation of income under the heads "Profits and gains of business or profession" or "Income from other sources".

ICDS IX relating to "Borrowing Cost" provides for capitalisation of borrowing costs in respect of qualifying assets. Qualifying assets are defined to mean tangible assets, intangible assets and inventories which take atleast 12 months to become saleable. ICDS IX provides that actual borrowing costs incurred during the period, on funds

borrowed specifically for the purposes of acquisition, construction or production of a qualifying asset, are to be capitalized on that asset.

In case of general borrowings i.e. not specifically borrowed for acquisition of a particular asset are utilised for acquisition, construction or production of a qualifying asset then general borrowing cost shall be capitalised in proportion of the cost of the qualifying asset to total assets of the taxpayer.

ICDS IX provides the formula for capitalisation of general borrowing cost i.e. $^{*}A \times \frac{B^{**}}{C^{***}}$

Where:

*Borrowing costs incurred during the previous year except on specific borrowings

**Average of costs of qualifying asset as appearing in the balance sheet of a person on the first day and the last day of the previous year. In case the qualifying asset does not appear in the balance sheet of a person on the first day, half of the cost of qualifying asset.

***Average of the amount of total assets as appearing in the balance sheet of a person on the first day and the last day of the previous year, other than assets to the extent they are directly funded out of specific borrowings.

INR lakhs

	Plant 1 (Funded out of general borrowings)	**Plant 2 (Funded out of specific borrowings**
Borrowing cost considered	10	5
Average cost of qualifying asset	60 (20 + 100)/2	
Average of the amount of total assets	650(500 + 800)/2	
Borrowing cost to be capitalised	0.92 (10x60/650)	5

7. To analyze HotSip Limited in the retail tea and snacks industry using Porter's Five Forces framework, we must consider the impact of the following competitive forces:

1. Threat of New Entrants

Barriers to Entry: High

Economies of Scale: HotSip Limited operates on a large scale with 19,767 stores, creating significant barriers for new entrants due to the substantial initial investment required.

Brand Loyalty: HotSip enjoys a strong brand presence and a loyal customer base, making it challenging for new entrants to attract customers.

Capital Requirements: Competing with established players like HotSip necessitates substantial investments in store setup, marketing, and maintaining quality standards.

2. Bargaining Power of Suppliers

Supplier Concentration: Medium

Key Inputs: Tea leaves are a crucial input, and fluctuations in tea leaf prices can impact profitability. Global tea demand influences supply and prices.

Supplier Power: While there are multiple tea leaf suppliers, global price increases due to demand and supply imbalances give suppliers some leverage. However, an anticipated decrease in tea leaf prices could weaken supplier power in the future.

Switching Costs: HotSip may face challenges in switching suppliers due to the need to maintain quality standards and specific blends that align with their brand.

3. Bargaining Power of Buyers

Buyer Concentration: Low

Customer Base: HotSip boasts a large and diverse customer base across various locations, reducing the bargaining power of individual buyers.

Product Differentiation: High-quality, premium-priced tea offerings and unique customer experiences diminish buyer power as customers value these distinguishing factors.

Price Sensitivity: During economic downturns, consumers may seek lower-priced alternatives, increasing their bargaining power. However, as economic conditions improve and disposable incomes rise, buyer power may decline.

4. Threat of Substitutes

Availability of Substitutes: High

Substitute Products: Various alternatives such as coffee, soft drinks, juices, and low-priced tea options are easily accessible to consumers.

Switching Costs: Consumers face minimal costs when transitioning to other beverage options, thereby heightening the threat level.

Consumer Preferences: Shifting consumer preferences towards healthier beverage choices due to health trends could pose a threat to HotSip if it fails to adjust its product range accordingly.

5. Industry Rivalry

Competitive Intensity: High

Number of Competitors: HotSip faces significant competition from well-established brands like DrinkTea, Donald's Tea, and Home Tea.

Market Share: HotSip currently holds a dominant market share of 46.7%, with DrinkTea Brands following at 24.6%. The rest of the market is divided among other competitors.

Growth Rate: The industry is projected to grow at a rate of 3.9% annually over the next five years, indicating a potential increase in rivalry as companies strive to capture more market share.

Product Differentiation: HotSip distinguishes itself by offering high-quality, premium products and unique customer experiences, although competitors are likely to enhance their offerings as well.

Conclusion

Operating in a competitive landscape marked by high entry barriers, moderate supplier influence, low buyer power, significant threat of substitutes, and fierce rivalry, HotSip Limited must maintain its competitive edge. This can be achieved by capitalizing on its strong brand, expansive network, top-notch product range, adapting to evolving consumer preferences, and exploring strategic partnerships.

CASE STUDY 45

Indian Watches Private Ltd. (IWPL) manufactures smart watches. IWPL had a turnover of over ₹560 crores in the preceding financial year. It had outstanding loans or borrowings from banks upto ₹ 80 crores in the preceding financial year. The paid up capital of the company is ₹ 20 crores.

Smart watches require a number of electronic components likes sensors, semi conductors, touch screen, batteries etc. Each smart watch requires many types of these components in order to be fully functional. The level of obsolescence is high in these components due to constant technological progress and design changes. Recently, during a management review meeting, the production manager complained about the delay in assembly line activities. Electronic components from the stores department were not being supplied on time at the assembly line. The store room manager explained that the delay was primarily caused because of fast obsolescence of components. There has been an inventory pile up of such obsolete components, many of which were bought in bulk but could not be used in the smart watch as there had been a technological / design change of the component in the meantime. Over the years, these items have accumulated and have started taking up substantial place within the storage area for components. Due to this, retrieval of components that are currently usable is taking time and hence the delay in delivering components to the assembly line.

Production of smart watches happen in large scale and is considered a high volume business. The company is using Total Productive Maintenance for maintaining and improving its production process. Total production per day is 5,000 watches each day. The smart watches are manufactured using several automated machines.

One of the processes in assembly uses an automated machine that requires 4 seconds per watch. The machine is operated on an 8 hour shift basis. In addition during each shift, the machine has a 60 minute break period and a 20 minute clean up period. Unplanned downtime is on an average 20 minutes for the machine per shift. Out of the 5,000 watches that undergo this assembly process each day, 95 watches are not assembled properly, so these are considered defective units.

Indian Watches Private Limited (IWPL) has decided to increase its production capacity to 20,000 watches per day. For this purpose, it imported an equipment from United States of America (USA) for $100,000. The date of entering into contract was April 30, 2024. The date of actual importation was May 25, 2024. On this date, the price of the equipment increased to $110,000. However, IWPL had already settled the contract by paying $100,000 to the exporter on April 30, 2024. Post importation, IWPL has further agreed to pay $20,000 as license fee and service fee for the equipment to the exporter in USA. This is part of the condition for sale.

IWPL imported sensors from Watches Inc. that is based in USA. These sensors as assembled onto the circuit boards of the smart watches and form a core component of the watch. Watches Inc. holds 4% of the equity share capital of IWPL. Each sensor is imported at $10 per unit. Subsequently, following IWPL's plans to increase its production capacity from 5,000 watches to 20,000 watches, it was decided that revised price for each sensor would be $8 per unit. When imports at the reduced price were effected, the Department rejected the transaction value stating that the price was influenced by the relationship between the said parties. It completed its assessment based on the earlier import price of $10 per unit of sensor.

Until last year, IWPL was collaborating with OSoft Private Limited (OSPL) for its software requirements that are installed within the smartwatches. During these interactions, the management at IWPL noticed the talented pool of software engineers, who were able to provide unique software applications for IWPL. Therefore, after few rounds of negotiation, IWPL recently acquired OSPL for ₹20 crores. The operations of OSPL will continue as before. All the software developed by OSPL will be used exclusively in smartwatches manufactured by IWPL. These applications that can increase the efficiency and utility of its smart watches. Recently the software engineering team that integrated with IWPL developed a navigation application that helps the user navigate required routes as well as suggest alternate routes to avoid traffic. The smartwatch series that included this navigation application saw a spurt in sales due to this feature, giving IWPL a competitive advantage over its rivals.

I. Multiple Choice Questions

1. Which of the following techniques may be useful in resolving the problem of delay in delivery of components from the store to the assembly line?

   (a) Economic order quantity

   (b) 5S methodology

   (c) Just in Time production

   (d) Cellular Manufacturing

2. By improving the process for timely availability of the electronic components to the assembly line, which of the components of Overall Equipment Effectiveness (OEE) is impacted?

   (a) Availability of Machine

   (b) Performance of Machine

   (c) Quality Losses

   (d) Cost of machine

3. Which of the following will hold true for IWPL as per the provisions of Companies Act, 2013?

   (i) By the Articles of Association, IWPL can appoint its founder Mr. Lal as its Managing Director for life.

   (ii) IWPL has to have a Whole Time Company Secretary since it has a paid-up share capital of 20 crore rupees.

   (iii) IWPL has to appoint is required to appoint an Internal Auditor and mandatorily conduct an internal audit.

   (iv) IWPL is required to appoint Independent Directors on their Board with the view to boost the level of corporate governance.

   Options

   (a) (i), (ii) and (iii)

   (b) (i) and (ii)

   (c) (ii) and (iii)

   (d) (i), (ii) and (iv)

4. Acquisition of OSPL by IWPL is an example of:

   (a) Backward integration

   (b) Forward integration

   (c) Horizontal integration

   (d) Merger

5. If it is found that the navigation tool incorporated in the smartwatch is not user friendly and too complex to operation. Which attribute of the Kano Model will the aspect of complexity in usage fall under?

   (a) Performance attribute

   (b) Questionable attribute

   (c) Threshold attribute

   (d) Reverse quality

II. Descriptive Questions

6. (i) Calculate the following:

   (a) Availability ratio

(b) Performance ratio

(c) Quality ratio

(d) Overall Equipment Effectiveness (OEE)

(ii) How can OEE be used to improve performance measurement in Total Productive Maintenance (TPM) assessments?

Compare the OEE of this process and equipment with the parameters suggested by to Dal *et al* (2000), Nakajima (1998) to determine world class performance and identify the parameter that can be improved.

7. (i) Given the increase in the price of the equipment between the date of contract and the date of actual importation, at what value should the imported equipment be assessed as per the Customs Act, 1962 and the relevant rules as applicable.

(ii) What should be the treatment of the license and service fee that IWPL has to pay to the exporter post importation?

(iii) With reference to IWPL's import of sensors from Watches Inc. the import price for each sensor was reduced from $ 10 per unit to $ 8 per unit. The Department completed its assessment based on the original import price of $ 10 per unit of sensor, citing that the 4% share holding in equity capital by Watches Inc. influenced the price. Is the Department's action sustainable in law?

ANSWERS TO THE CASE STUDY 45

I. Answers to the Multiple Choice Questions

1. (b) 5S methodology

Reason: 5S methodology which is a Japanese methodology for Total Productivity Management (TPM) that is used to improve efficiency and effectiveness of an organization's workspace. The 5 S can be translated as They can be translated from the Japanese as "sort", "set in order", "shine", "standardize", and "sustain".

EOQ relates to the quantity of inventory a company has to purchase to reduce inventory and storage cost. Just in time production refers to production of a product only as and when demand is generated by the customer. This will not help resolve the delay in delivery of components (raw materials for the finished product) from the store to assembly line. Cellular manufacturing refers to group of machines working in a cluster, operated by a single worker that will reduce work in progress and defective manufacturing.

2. (b) Performance of Machine.

Reason: Timely availability of the electronic components to the assembly line reduces machine idling and minor stoppages, two of the "six big losses" while calculating OEE. Reduction of idling and minor stoppage improves the performance of the machine and thereby the OEE of the machine. Availability of electronic component i.e. raw material, does not directly impact the availability of the machine nor the quality of the product. Cost of the machine is not any part of the "six big losses" used to measure Total Productive Maintenance, for which Overall Equipment Effectiveness (OEE) is calculated.

3. (c) **S**tatements (ii) and (iii) are true for IWPL as per the provisions of Companies Act, 2013.

Reason: Option (i) is wrong Section 196(2) of the Companies Act, 2013 lays down that no company shall appoint or re-appoint any person as its managing director, whole-time director or manager for a term exceeding five years at a time.

Option (ii) is correct Section 203 and Rule 8A requires a private company with paid up share capital of ₹10 crores or more shall have whole time Company Secretary.

Option (iii) is correct Section 138 of the Companies Act 2013, every private company having a turnover of ₹200 crore and above during the preceding year or having outstanding loans or borrowings from banks or public financial institutions exceeding ₹100 crores at any point of time during the preceding financial year has to appoint an internal auditor and mandatorily conduct an internal audit. IWPL has turnover of ₹560 crores in the preceding year and therefore has to appoint an internal auditor.

Option (iv) is incorrect as appointment of Independent Directors as per Section 149 applies to listed companies and other public companies.

4. (a) Backward integration

Reason: Backward integration, OSPL was a supplier of software applications and solutions to IWPL before the integration. OSPL was part of its upstream supply chain. IWPL acquired its supplier OSPL for ₹20 crores. Hence, this is an example of backward integration.

5. (d) Reverse quality

Reason: Reverse quality**,** where complexity in using the navigation tool leads to dissatisfaction of customers.

II. Answers to the Descriptive Questions

6. (i) (a) to (d)

(a) Availability Ratio (Table 1)

Sr. No.	Particulars	For 1 machine per shift
1	Total time available (in minutes) 8 hours * 60 minutes	480
	Less Planned downtime in minutes	
2	Break in minutes	60
3	Clean up time in minutes	20
4	Planned production time in minutes Step 1 - (Step 2 + Step 3)	400
5	Unplanned downtime (in minutes)	20
6	Available time in minutes Step 4 - Step 5	380
7	Availability ratio per shift (Step 6 / Step 4)	95.00%

(b) Performance Ratio (Table 2)

Sr. No.	Particulars	For 1 machine per shift
1	Actual production per day (units)	5000
2	Standard time (seconds)	4
3	Standard time required (minutes) Step 1 * Step 2 / 60	333.33
4	Actual Time taken (minutes) (Refer Step 6 from Table 1)	380
5	Performance Ratio (step 3/step 4 in %)	87.72%

(c) Quality Ratio (Table 3)

Sr. No.	Particulars	Units
1	Actual Production per day	5,000
2	Defective units per day	95
3	Quality Ratio (Step 1 - Step 2)/Step 1 in %	98.10%

(d) Overall Equipment Efficiency (OEE) = Availability Ratio * Performance Ratio * Quality Ratio

= 95% x 87.72% x 98.10% = 81.75%

(ii) Total Production Maintenance (TPM) study is undertaken improve the efficiency of manufacturing process by minimizing breakdowns and delays. Calculating Overall Equipment Efficiency (OEE) requires the identification of "six big losses"

- Equipment failure / breakdown
- Set-up adjustments
- Idling and minor stoppages
- Reduced Speed
- Reduced Yield and
- Quality Defects and Rework

The first two losses (breakdown and set up adjustments) determine the availability of equipment, the next two losses (idling and minor stoppages and reduced speed) determine productivity efficiency and the last two losses (reduced yield and quality defects/rework) determine quality losses. Identification of these losses can provide information that can be used to improve the efficiency of manufacturing process.

Comparing the performance at the assembly line process with the parameters suggested by Dal et al (2000), Nakajima (1998)

Parameter	Suggested benchmark	Actual at assembly line
Availability	>90%	95.00%
Performance Ratio	>95%	87.72%
Quality Ratio	>99%	98.1 %
Overall OEE	85%	81.75%

The overall OEE of 85% and above is considered world class performance. The actual OEE at the assembly line process is 81.75%, close to but below the world class performance. As can be seen above, the performance ratio of 87.72% is below the benchmark of 95% and above. The actual time taken is influenced by both planned downtime and unplanned downtime. The production manager can investigate this further to determine where improvements can be made.

7. **(i)** As per section 14 of the Customs Act, 1962, the value of the equipment will be the actual price paid or payable that is the transaction value for the equipment. In this case, the transaction value will be $100,000 which is the price of the contract and the amount actually paid by IWPL to the exporter on April 30, 2024. Price

increase between the date of contract and the date of actual importation is therefore irrelevant for the purpose of valuation under Customers Act, 1962.

(ii) IWPL has agreed to pay the exporter, as a condition for the sale, $20,000 as license and service fee post importation of the equipment. As per explanation to Rule 10(1), this has to be included in the value of the equipment as this payment is being made as a condition to sale.

(iii) No, the Department's action is not sustainable in law. Rule 2(2) of the Customs Valuation (Determination of Value of Imported Goods) Rules, 2007, inter alia provides that persons shall be deemed to be "related" if one of them directly or indirectly controls the other. The word control has not been defined under the Rules. As per common parlance, control is established when one enterprise holds at least 51% of the equity shareholding of the other company. However, in this case Watches Inc. holds only 4% of the shareholding of the IWPL. So, the two parties cannot be said to be related. The fact the IWPL decided to expand its operations, leading to increase in bulk imports could be a reason for the reduction in import price. The burden to prove undervaluation lies with the Revenue. In the absence of evidence to prove under-valuation, the price declared by IWPL is acceptable.

CASE STUDY 46

Due to increased urbanization, there has been a strong demand for residential housing facilities in various cities in India. Residential housing construction in each region is largely a fragmented market dominated by local and regional builders. Few builders have a nationwide presence. Residential construction is segmented by type, that is apartments and condominiums, villas and other types. Most of the apartments' construction is aimed at the mid-range income to luxury segment of customers. There are very few players targeting the low-income customers who are also in need of affordable housing facilities. The need for affordable housing is especially felt in well-developed cities like Pune, Bangalore, Gurgaon and Ahmedabad that have become urban centers in the last few decades. Housing facilities catering to the low-income customer segment are generally of poor quality, consequently, are prone to unfortunate accidents.

Bhartiya3D (B3D) is a company established by Mrs. Sinha, an architect and avid innovator. She has been a seasoned professional having more than 25 years of experience in the construction industry. She is also an innovator who wishes to harness the power of technology that can revolutionize the construction industry. ***"Provide over each head a safe and secure roof, without a huge debt" is the current vision for her latest project.*** B3D specializes on building 600 sq. ft to 800 sq. ft single- and two-bedroom homes using 3D technology. This is a revolutionary innovation in the construction industry. Traditional construction involved developing a blueprint for the home, then procure men, material and machines to work on the home. Completing a project the traditional way can take months, up to even more than a year in some cases.

B3D plans to turn this concept on the head, by introducing 3D printing technology for construction. Once the blueprint is finalized, the 3D construction printer takes over and creates the physical structure by printing out layers of concrete based on the design and specifications in the blue print. This substantially reduces wastes, errors and time required for construction in addition to generating better quality output. One housing project can be built within 6 months as compared to a period of 18 months for a similar project built using traditional construction techniques.

As compared to traditionally built homes, the cost of construction of 3D printed homes are expected to be cheaper. An advantage of using 3D construction technology is that it reduces the need for construction labourers as many of the processes are automated. This results in the reduction of construction labour cost by almost 40%. Also, reduction in wastes and errors helps in managing costs better. B3D is in talks with 3D construction printer manufacturers to procure machines needed for construction. These are costly machines that require huge initial investment. B3D is considering financing options for procurement of these machines, currently the loan financing rates are high. Due to limited supply in the face of high demand for prime locations, the cost of land procurement in these fast-developing urban centres is also high.

Inflationary pressures on cost of materials, labour and other constructions costs, high financing costs etc. are challenges that B3D expects to encounter. Hence, generating a quick inventory turnover is critical.

B3D has well qualified engineers and architects who will be working on this project. Since B3D plans to build these 3D homes across different cities, their expertise will be required at multiple locations. Hence, in order to retain them and motivate them, the company has offered good remuneration packages to them. For the staff it is a matter of pride to be able to be part of such innovative projects.

B3D wants construction material such as cement and steel need to be of specific quality. There are limited suppliers who can provide material of such grade quality. Moreover, B3D's material requirements form a very small portion of the suppliers' market. Many times, the lead times for procuring these materials are uncertain. Construction material includes bricks and glass that are very fragile and difficult to store. These materials are widely available in the market with many suppliers and can be procured easily on demand. B3D is considering its strategy for inventory management for each of the requirements like cement, steel, bricks and glass.

B3D targets to achieve low cost of production, less lock in of time and capital for each project. Keeping this in mind, the company plans to price the houses at a very attractive price of ₹ 10 lakhs for a single bedroom flat and ₹ 12 lakh for double bedroom flat in prime locations in urban cities across India. On average, similar traditional homes costs around ₹ 15 lacs per single bedroom flat and ₹ 18 lakh for double bedroom flat in the same locality. This will bring a lot of relief for this segment of customers who until now were dependent on the traditional builders for their home shelter needs. B3D targets to make a profit of at least 8% on sale price per flat. At present, it plans to have a uniform selling prices for single bedroom and double bedroom flats across cities in order to popularize the projects. However, there is flexibility for B3D to charge according to the exact cost considerations for each location in each city. Incumbents in the real estate cannot compete at this low range pricing, hence the company expects them to concentrate their business on the higher end segments for middle income and luxury class segments.

B3D has received the requisite approvals for the projects from town planning and other regulatory authorities. To create awareness and generate demand among the lower income groups, it plans to advertise its products in vernacular newspapers and TV channels. This would ensure better reach to the target customer segment. The cost of advertising in these channels is also cheaper as compared to other mediums. B3D will have a sales office at each project website, which will handle customer enquiries and take them on site tours in order to familiarize themselves with this novel building project.

B3D wishes to create traction on its sales quickly in order to capitalize on its revolutionary concept. Hence, B3D has tied up with Smart Bank Ltd. This is a reputed bank that has a national presence. It has vetted and listed B3D's project across various cities as one of its approved

projects for which it is willing to provide loans along with assistance with loan processing. This tie-up gives further credibility in the market for this novel housing project.

Since customers are of the lower income group, the probability of their requirement for loan financing would be higher. Hence where felt appropriate, the sales team of B3D would encourage customers to approach Smart Bank Ltd. for home loans. Fast loan processing due to pre-approved tie-up, speeds up fund procurement and the transaction can be completed quickly, improving churn in sales. Smart Bank Ltd. will also use its digital marketing activities and direct selling agents who will advertise the availability of home loan facilities through these channels. For each loan that gets approved through this tie-up, B3D gets a small commission on each transaction. B3D expects at least 85% of the potential customers to utilize the tip-up with Smart Bank Ltd. to avail loans.

Bhavna, an engineer in the research and development team, has been working on making the construction process more efficient. Consequently, it can reduce the cost of construction. Given, the spectre of inflationary pressures on cost of operations, this project is considered to be critical to business and has the support of the senior management at B3D. Required finances have been approved by the management for this project i.e., efficient 3D construction technology. Project costs are easily identifiable and quantifiable. Bhavna believes that the cost reductions will exceed the project costs within 36 months of their implementation. Regulatory testing, health and safety approvals were obtained on June 1, 2022. This removed uncertainties concerning the project, which was finally completed on April 30, 2023. Costs of ₹ 24,00,000 incurred until March 31, 2023 have been recognized as an intangible asset. An offer of ₹ 17,00,000 has been received from a third party potential buyer, but it was rejected by B3D, believes that the project will be a major success and that the B3D has the potential to save ₹ 19,00,000 in perpetuity. However, Mrs. Sinha, the head of the research and development team, is concerned about the long term prospects of the new process. She is of the opinion that competitors would have developed new technologies at some time which would require to replace the new process within five years. She estimates the present value of future cost savings over this period to be ₹ 18,00,000. After that, she feels there is no certainty about the future.

In order to know the state of art developments in the 3D construction business, B3D engages technical consulting services of Pathway Consulting GMBH, a consulting company in Germany. In December 2023, it had paid ₹ 25,00,000 as fees for technical services fees to this company. This was paid to the company's account in Germany. The accountant engaged at B3D was new to the job and did not deduct TDS on this payment. B3D paid the relevant TDS in December 2024.

The management of B3D is considering the following capital budgeting report for its first project in Pune. Due to the novel nature of the project, the management wishes to know the guaranteed return that it would rather accept as compared to a higher but uncertain return. Accordingly, the capital budgeting analysis has incorporated the certainty equivalent co-efficient of future cash flows.

Total investment in the project in Pune ₹ 5 crores.

Risk free return 3%

Expected cash flow for the next five years

Year	Expected cash flow (₹)	Certainty Equivalent co-efficient
1	1 crore	0.95
2	2 crores	0.90
3	2 crores	0.85
4	3 crores	0.80
5	2 crores	0.75

In May 2023, B3D enters into a lease with AK Enterprises for a 3D construction printer for the Pune project for a period of 3 years. The contract stipulates that AK Enterprises will perform maintenance of the leased 3D construction printer and receive consideration for that maintenance service. The contract contains the following fixed prices for the lease and non-lease component:

Lease component for 3D printer	₹ 6,00,000 per annum
Maintenance component for 3D printer	₹ 1,00,000 per annum
Total payment made to AK Enterprises	₹ 7,00,000 per annum

Assume that the stand-alone prices cannot be readily observed, so B3D makes estimates maximizing the use of observable information of the lease and non-lease components as follows

Lease component for 3D printer	₹ 8,00,000 per annum
Maintenance component for 3D printer	₹ 2,00,000 per annum
Total payment made to AK Enterprises	₹ 10,00,000 per annum

B3D has not opted for the practical expedient option regarding the lease and non-lease component.

I. Multiple Choice Questions

1. Which type of disruption does the introduction of 3D printing in the real estate sector represent?

   (a) Low end disruption

   (b) New market disruption

   (c) competitive disruption

   (d) Generic disruption

2. From the case scenario, which stage of startup is B3D in and what is the value proposition match has it achieved?

   (a) Pre-start up stage with problem-market FIT stage

   (b) Pre-start up stage with problem-solution FIT stage

   (c) Start up stage with product-market FIT stage

   (d) Start up stage with scale-FIT stage

3. B3D is considering its strategy for inventory management. Given the information in the case study about the lead times, availability of suppliers and negotiating powers with suppliers, which of the following inventory management methodologies can the company follow for these products?

   (a) Just in Time Purchasing for all construction materials like bricks and glass, cement and steel.

   (b) Just in Time Production for all construction materials like bricks and glass, cement and steel.

   (c) inventory to stock for materials like bricks and glass and Just in Time Production for construction materials like cement and steel.

   (d) Inventory to stock for construction materials like cement and steel while Just in Time purchasing for materials like bricks and glass.

4. Which of the following is instrumental in B3D's low cost advantage strategy?

   (a) Cost effective inputs

   (b) Low cost distribution channels

   (c) Economies of scale

   (d) Process Innovation and re-engineering

5. The net present value of the project in Pune using the certainty equivalent technique would be:

   (a) ₹ 3.35 crores

   (b) ₹ 2.60 crores

   (c) ₹ 4.07 crores

   (d) ₹ 5.00 crores

6. What will be the allocation of consideration paid by B3D for the lease and non-lease component against the contract with AK Enterprises for 3D printer?

(a) Lease component ₹ 6,00,000 per annum and non lease component ₹ 1,00,000 per annum

(b) Entire payment of ₹ 7,00,000 per annum as lease component as B3D has not opted for practical expedient regarding the lease and non lease components

(c) Lease component ₹ 8,00,000 per annum and non lease component ₹ 2,00,000 per annum

(d) Lease component ₹ 5,60,000 per annum and non lease component ₹ 1,40,000 per annum

7. What would be the implication of non-deduction of TDS in the P.Y. 2023-24 for the fees for technical services of ₹ 25,00,000 paid to Pathway Consulting GMBH?

(a) There is no implication of non-deduction of TDS for fees for technical services as it is paid outside India, namely to Pathway Consulting GMBH account in Germany.

(b) There is no implication of non-deduction of TDS for fees for technical services as it was paid in December 2024.

(c) The fees for technical services will not be allowed as a deductible expenditure for the Assessment Year 2024-25.

(d) The fees for technical services is not subject to the TDS provisions and hence B3D need not have paid the TDS at all in December 2024.

II. Descriptive Questions

8. B3D wants to ensure that its business model has a competitive advantage over its rivals. DEVELOP Osterwalder's Business Model Canvas to help the management understand the key elements of its business model.

9. ADVISE the appropriate accounting treatment for the research and development costs incurred by Bhavna to make construction process more efficient that will consequently result in future cost savings.

ANSWERS TO THE CASE STUDY 46

I. Answers to the Multiple Choice Questions

1. (a) Low end disruption.

Reason: B3D is targeting low-income customer segment currently existing in the real estate market by offering them affordable homes using innovative 3D technology at highly attractive rates that cannot be matched by incumbents. Hence, it plans to enter the market at the lower priced product segment.

Incumbents due to their inability to compete with the company, are expected to concentrate their business on higher end segments for middle income and luxury class segments.

Also, disruptive innovation is of two type low end disruption and new market disruption

2. (c) Start up stage with product-market FIT stage

Reason: B3D is in the start up stage with product-market FIT stage. Getting regulator approvals, arranging for operational requirements in terms of men, machines and money, strategic tie-ups that will help its reach in the market, ongoing research and development activities to reduce costs of operations. All this indicates a commitment from B3D to get customer validation for the 3D affordable housing project that it wants to the market. Its offering will be tested in the market through its first project in Pune, where customer demand is expected to be generated and the value proposition starts generating cash flow, the company moves to the start – up stage with product-market FIT of its value proposition.

3. (d) Inventory to stock for construction materials like cement and steel while Just in Time purchasing for materials like bricks and glass.

Reason: Inventory to stock for construction materials like cement and steel. B3D wants the materials to be of specific quality grade. It also seems from the scenario, that the company may not be able to have sufficient negotiating power with the suppliers. Also, the lead time for procurement of material is uncertain. Hence, the ideal method would be the stock these inventories.

Just in Time purchasing will work well where the construction material like bricks and glass are very fragile and difficult to store. These materials can be procured only when needed in order to avoid loss due to storage due to their fragility. Loss will be incurred if the inventory is stocked and stored due to their fragility. It is given that These materials are widely available in the market with many suppliers and can be procured easily on demand. Hence, Just In Time purchasing requirements would be an ideal method for these inventories.

4. (d) Process innovation and re-engineering

Reason: Process innovation and re-engineering achieved through the use of 3D printing technology

5. (b) ₹ 2.60 crores. Calculation as below

Reason:

$$DCF = \frac{(₹1\text{ crore}) \times 95}{(1.03)} + \frac{(₹2\text{ crore}) \times 0.90}{(1.03)^{\wedge} 2} + \frac{(₹2\text{ crore}) \times 0.85}{(1.03)^{\wedge} 3} + \frac{(₹3\text{ crore}) \times 0.80}{(1.03)^{\wedge} 4} + \frac{(₹2\text{ crore}) \times 0.75}{(1.03)^{\wedge} 5}$$

= ₹ 92,23,300 + ₹ 1,69,66,726 + ₹ 1,55,57,408 + ₹ 2,13,23,689 + ₹ 1,29,39,131

= ₹ 7,60,10,356

NPV = DCF – initial investment = ₹ 7,60,10,356 - ₹ 5,00,00,000 = ₹ 2,60,10,356 that is ₹ 2.60 crores.

6. (d) Lease component ₹ 5,60,000 per annum and non lease component ₹ 1,40,000 per annum

Reason: The stand alone price for the lease component represents 80% of the total estimated stand alone prices [₹ 8,00,000/₹ 10,00,000]. Therefore, B3D allocates the consideration in the contract i.e. ₹ 7,00,000 per annum as follows:

Lease component for 3D printer 80% × ₹ 7,00,000 per annum	₹ 5,60,000 per annum
Maintenance component for 3D printer 20% × ₹ 7,00,000 per annum	₹ 1,40,000 per annum
Total payment made to AK Enterprises	**₹ 7,00,000 per annum**

7. (c) The fees for technical services will not be allowed as a deductible expenditure for the Assessment Year 2024-25

Reason: Under section 40(a)(i), where fees for technical for technical services is paid outside India on which tax is deductible at source under Chapter XVIIB and such tax has not been deducted, the expense shall be disallowed. Therefore, the fees for technical service will not be allowed as a deductible expenditure for the A.Y. 2024-25. However, since tax has been paid in December, 2024, the fees for technical services will be allowed in A.Y. 2025-26.

II. Answers to the Descriptive Questions

8. Osterwalder's Business Model Canvas comprises of nine elements, wherein four elements pertain to cost (key partners, key activities, key resources and cost structure). These are connected to the other four elements pertaining to revenue (customer relationships, channels, customer segments and revenue streams). This link is established through the nineth segment, value proposition.

Key Partners:

B3D relies on several key partners to support its operations and growth in the construction industry. This includes ***suppliers of essential components*** such as 3D construction printing machines, specialized cement, and steel required for 3D printers, as well as other construction materials like bricks and glass. ***Suppliers of construction labour*** are also crucial partners in executing projects efficiently.

Furthermore, B3D has formed a ***strategic tie-up with banks like Smart Bank Ltd***. This partnership enhances market reach by facilitating easier access to financing for potential

customers. Additionally, ***consulting firms providing technical insights*** on the latest developments in construction technology play a vital role in B3D's innovation and continuous improvement efforts.

Key Activities:

B3D engages in several key activities to drive its business and innovation in the construction industry. First and foremost, it meticulously follows ***advanced construction techniques, coordinating the necessary manpower, materials, and machinery*** to complete projects within a swift 6-month timeframe. This efficient project management ensures timely delivery and customer satisfaction.

Secondly, B3D places a strong emphasis on ensuring that construction materials meet the required specifications and quality standards necessary to support 3D printing technology. This ***commitment to quality*** enhances the durability and efficiency of its construction processes.

Additionally, B3D invests significantly in ***research and development activities to maintain a competitive edge***. These efforts focus on innovation in 3D printing technology and construction methodologies, enabling B3D to stay ahead in the market and continuously improve its offerings.

To facilitate quick inventory turnover and boost sales, B3D employs ***targeted advertisements and leverages its strategic partnership*** with Smart Bank Ltd. This collaboration not only expands its customer reach but also facilitates easy financing options for potential buyers, thereby accelerating sales and project timelines.

Moreover, B3D ***evaluates the creditworthiness of customers*** interested in outright purchases and actively encourages the use of home loans through Smart Bank Ltd. This approach ensures that financing solutions are accessible to a broader customer base, making homeownership more achievable for low-income segments.

Key Resources:

B3D relies on key resources essential for its operations and innovation in the construction sector. At the core of its technological advancement are ***3D construction printers***, which enable efficient and precise construction of residential units. These printers are pivotal in realizing B3D's goal of delivering high-quality, affordable housing using advanced technology.

Another critical resource for B3D is its ***team of employees specialized in engineering and architecture***. These professionals bring expertise in designing and overseeing the implementation of 3D printing technology in construction projects. Their skills and knowledge are crucial for maintaining operational excellence and driving continuous improvement.

In addition to tangible resources like 3D printers and skilled personnel, B3D leverages ***intangible assets*** such as patents and process improvements generated through its research and development activities. These intangible assets not only protect B3D's innovations but also provide a competitive edge in the market by enhancing efficiency, reducing costs, and improving the quality of its construction projects.

Value Proposition of B3D:

B3D addresses the pressing customer problem of the ***lack of good quality, affordable housing facilities*** in urban cities in India. By leveraging 3D construction printing technology and other innovative technological solutions, B3D ***provides secure and affordable housing facilities***, revolutionizing the construction industry and meeting the urgent needs of low-income customers in these urban centers.

Customer Relationships:

B3D maintains customer relationships by managing a mass customer base through sales offices at each project site. These ***offices conduct site tours and handle queries*** about the novel 3D construction project, ensuring that potential buyers are well-informed and engaged throughout the purchasing process.

Channels:

B3D utilizes multiple channels to reach its customers effectively. ***Sales offices are established at each project site*** to directly engage with potential buyers. Additionally, B3D ***leverages its tie-up with Smart Bank Ltd.***, which publicizes the projects through digital marketing activities and direct selling agents, ensuring wide reach and visibility among potential customers.

Customer Segments:

B3D targets lower-income customers in urban cities across India who are in need of affordable housing facilities. The customer base consists of two types: those making ***outright purchases*** and those ***requiring financial assistance*** for home purchases.

Revenue Streams:

B3D's primary revenue stream comes from the ***sale of residential units***, with a uniform selling price of ₹ 10 lakh per single bedroom flat and ₹ 12 lakh per double bedroom flat to popularize the scheme. There is flexibility to adjust prices upward based on cost considerations for each project across multiple cities, with a target profitability of 8% of the sale price of each flat.

In addition to direct sales revenue, B3D ***generates ancillary income through commissions*** from its partnership with Smart Bank Ltd. This collaboration facilitates loan approvals for customers, enhancing affordability and enabling quicker sales turnover.

This dual revenue model ensures that B3D not only meets the housing needs of lower-income segments but also maximizes its financial performance through strategic pricing and financial partnerships.

Cost Structure:

B3D's cost structure involves various management opportunities and challenges. On the ***opportunity side***, utilizing 3D construction technology yields higher quality construction while reducing waste, errors, and time due to automated processes. This efficiency allows for better inventory management of materials like cement, steel, bricks, and glass, and decreases construction time, lowering labor costs by almost 40% and reducing overhead expenses. However, B3D ***faces several challenges***, including high land acquisition costs, significant expenses for 3D printing machines, and the need for higher remuneration for skilled employees such as engineers and architects. Additionally, the specialized materials required for 3D printing are costly, inflation impacts other construction costs, and financing costs remain high.

9. Ind AS 38 'Intangible Assets' requires an intangible asset to be recognized if, and only if, certain criteria are met.

- Intention to complete the asset is apparent as it is a major project with full support from board
- Finance is available as resources are focused on project
- Costs can be reliably measured
- Benefits are expected to exceed costs – (in 3 years)
- Regulatory approval which was received on June 1, 2022

Regulatory approval for the project was received on June 1, 2022. The project was completed on April 30, 2023. Costs of ₹ 24,00,000 incurred until March 31, 2023 have been recognized as an intangible asset. This is incorrect.

Expenses incurred prior to June 1, 2022 should be expensed out: ₹ 24,00,000×2/12= ₹ 4,00,000. Retrospective recognition of expense as an asset is not allowed.

Expenses incurred between June 1, 2022 and March 31, 2023 should be capitalized: ₹ 24,00,000×10/12= ₹ 20,00,000

Ind AS 36 'Impairment of assets' requires an intangible asset not yet available for use to be tested for impairment annually. As of March 31,2023 the asset is not yet available for use, hence it has to be tested for impairment. Cash flow of ₹ 19,00,000 in perpetuity would clearly have a present value in excess of ₹ 19,00,000 and hence there would be no impairment. However, the research head Mrs. Sinha is technically qualified, so impairment tests should be based on her estimate of a five-year remaining life and so present value of the future cost savings of ₹ 18,00,000 should be considered in that case.

₹ 18,00,000 is greater than the offer received (fair value less cost to sell) of ₹ 17,00,000 and so ₹ 18,00,000 should be used as the recoverable amount.

The carrying amount should be consequently reduced to ₹ 18,00,000.

Calculation of Impairment loss of intangible asset under development:

Particulars	**Amount (₹)**
Carrying amount of intangible asset as of March 31,2023	20,00,000
Less Recoverable amount	18,00,000
Impairment loss	**2,00,000**

Impairment loss of ₹ 2,00,000 is to be recognized in the profit and loss for the year 2022-23.

Necessary adjusting entry to correct books of account will be:

Particulars		**₹**	**₹**
Operating expenditure – Development expenditure	Dr	4,00,000	
Operating expenses – Impairment loss	Dr	2,00,000	
To Intangible asset under development			6,00,000

CASE STUDY 47

Background for establishment of Thunderbolt Airlines Private Limited (TAPL).

Avian Airlines Inc. is a renowned airline company with a global presence, headquartered in New York, United States of America. In the year 2000, Avian Airlines Inc. (AAI) established a branch office in Mumbai to handle its Indian flight operations. The Indian flight operations are handled only at the Mumbai airport. Passengers are either transported from Mumbai to destinations abroad or transported to Mumbai from overseas. There are no domestic flight operations within India. The Mumbai office handles routine day-to-day operations undertaken by junior and middle-level management staff. The work handled by the Mumbai office includes flight ticket booking and cancellation, managing Avian's airport lounge facilities, managing the check-in counters at the airport, assisting customers with services like in-flight meals, providing access to airport lounge facilities, providing flight information, travel insurance information, assisting with missing luggage queries, and any other customer-related services. At the same time, the place of effective management is outside India, and it is determined that Avian Airlines Inc. has an active business outside India.

Below are the details of revenue from business operations of operating aircrafts received by the Mumbai Branch office for the year ended 31st March 2024:

(i) ₹ 5 crores in India on account of carriage of passengers from Mumbai to destinations outside India

(ii) ₹ 2 crores in India on account of carriage of passengers from outside India to Mumbai

(iii) ₹ 3 crores in New York, United States of America on account of carriage of passengers from United States of America to Mumbai

The total expenditure incurred by AAI's Mumbai branch for the purpose of carrying out its operations in India is ₹8 crores.

The Indian economy is considered one of the fastest-growing economies, with projections for GDP growth of 7% year-on-year. Private consumption and growing economic activity in both the manufacturing and service sectors have spurred growth since 2022. Post-pandemic, with the easing of restrictions on civil aviation, consumers' appetite for travel has increased manifold. It is expected that domestic aviation will require at least 4,000 fleets within the next two decades to meet the anticipated growth in demand.

Since 2022, passenger traffic in India has increased. With the rise in disposable incomes, rapid urbanization, and an increase in the working-class population, the growth in demand for air travel is expected to remain constant. Tier 2 and Tier 3 cities are also expected to play a pivotal role due to the greater spread of economic activity and increasing population in these cities. The government is focused on building and expanding modern infrastructure facilities across

the country to support the domestic civil aviation industry. Almost 100 more new airports will be operational by 2028, giving scope for the development of new regional routes that can provide excellent connectivity within India. A growing economy will need to be supported by a burgeoning demand for international travel to and from India. Hence, India will require better connectivity with international destinations. This opens up the scope for developing newer routes to connect passengers across the globe.

TAPL, a Joint Venture between Avian Airlines Inc. and Power Group Limited

In order to be part of a growing market, Avian Airlines Inc. has decided to enter the Indian aviation industry. On April 1, 2024, AAI plans to enter into a joint venture with Power Group Ltd. (PGL), which is one of India's largest conglomerates with business interests in various sectors ranging from technology, automotive, infrastructure, to consumer and retail. Power Group Ltd. (PGL) is headquartered in Mumbai, India. Thunderbolt Airlines Private Limited (TAPL) is the joint venture between Power Group Ltd. and Avian Airlines Inc. Power Group Ltd. will have a 60% stake in the joint venture, while Avian Airlines Inc. will hold a 40% stake.

Avian Airlines Inc. is renowned for its full-service airline service, catering to the premium flying segment. On the other hand, Power Group Limited (PGL) has access to global markets due to its operations in various business segments. It has been a pioneer in many of the businesses it operates, hence it is considered one of India's most valuable conglomerates. The brand image of PGL has given it deep penetration in the Indian domestic market due to the various businesses it operates.

Most airlines in the Indian market operate as low-cost carriers (LCC). However, intense competition combined with inflationary pressures on input costs like ATF fuel, personnel costs, etc., means that margins are limited and always under pressure. Therefore, it has been decided to position TAPL as a full-service airline in the domestic civil aviation market. The targeted customer segment would be high-end business travelers in a price-sensitive market. Currently, 95% of the seating capacity within the domestic civil aviation sector is economy seats. The remaining 5% capacity consists of highly priced premium seats sold mostly to price-indifferent passengers, who form a very limited and niche market existing only on certain routes within the country. TAPL plans to offer a new segment of seats in its aircraft: “premium economy,” which combines the benefits of premium flying at affordable rates. Given that growing economic activity generally spurs the demand for business-related travel, TAPL plans to foray into the “premium economy” segment, positioned midway between economy seats and premium first-class seats.

While the rates may be slightly higher than the regular market price for economy seats offered by other airlines, for a small additional cost, passengers can avail themselves of benefits like customized service, faster check-in, and a better in-flight experience. All the seats in TAPL's aircraft will offer "premium economy" seating.

TAPL will have its main operational hub in Mumbai, which will serve as the nodal point for most of its domestic airline flights. It will also operate international flights to Dubai, where AAI has a major nodal hub for its international operations in Asia and the Middle East. Hence, a business flyer can connect to both domestic flights using TAPL's fleet as well as international destinations through AAI's fleet from Dubai.

TAPL's vision-*"To be the most loved, most efficient, and most valuable airline".*

TAPL's mission-*"To enhance customer experience by offering seamless connectivity".*

Avian Airlines Inc. will provide the technical and managerial support required to run a full-service airline. Power Group Limited (PGL), with its market presence and brand image, will provide access to the Indian aviation sector for AAI, acting as a stable and trustworthy partner in the joint venture. A few executives from AAI and PGL will be part of TAPL's management team for the initial years until the airline can manage its operations independently. These executives will be well-versed with TAPL's overall strategy, helping guide the company in its initial years of establishment. Once the "start-up" phase is over, TAPL will hire eligible executives with appropriate experience from the Indian market to oversee airline operations.

TAPL will have a hierarchical structure, with Mr. Tan being appointed as the Chief Operating Officer for India. Since TAPL is being developed as a full-fledged service carrier, it has been decided that decision-making, in the initial years of establishment, will follow a centralized model. Senior management at TAPL will comprise executives from AAI and PGL. Operations will be managed by AAI, given their expertise in the aviation sector, while PGL will oversee Sales & Marketing and Finance, being a recognized brand in India. The Directors of Operations, Finance, Human Resources, and Sales & Marketing will all report to Mr. Tan, who, in turn, reports to the Board Members at AAI and PGL.

As mentioned above, TAPL will have specific departments that will look into Operations, Finance, Human Resources, and Sales & Marketing. TAPL will invest in digitalization and the use of information technology to provide a high level of customized service to its passengers. Similarly, based on guidance from executives at AAI, workflows will be documented, established, and communicated throughout the organization. Digitalization can smooth process flows, make interactions less cumbersome, and speed up process times, all of which contribute towards cost efficiencies and enhanced customer satisfaction. Each department will have specific goals and performance measurement systems in place.

AAI and PGL are reputed companies with work cultures and ethics defined by the core values of their respective companies. The employees and other support partners of TAPL are expected to uphold similar values such as honesty, excellent work ethic, transparency in working, accountability, and trust. Both companies have a global presence. Hence, TAPL is expected to support a culture of diversity at its workplace in terms of gender, background, and age.

The aviation sector is a highly competitive industry. The success of the joint venture depends on the management leadership and teamwork at TAPL. It is expected that each department will

create synergy that merges the work cultures of both AAI and PGL. Cross-functional project teams will be deployed to build this synergy and foster team spirit. This will encourage creativity and motivate employees to work towards a successful venture.

Due to its competitive environment, the aviation industry is prone to high attrition due to employee poaching. TAPL aims to create value for its employees by offering attractive pay packages, facilities, and a conducive environment for professional growth. A high attrition rate could have a detrimental impact on a business that wishes to be a full-fledged premium service airline.

Since TAPL is targeting to be a full-fledged service carrier, it is important for the staff to be well-experienced both technically and in soft skills like customer service. TAPL is expected to hire pilots, engineers, and other technical staff who are already working at other airlines. They are also planning to collaborate with institutes that offer aeronautical engineering and aviation technology courses to hire a well-experienced and rounded pool of staff who are highly skilled, as well as to arrange for periodic training of staff. Senior executives of AAI, who are deputed to TAPL, will be in charge of ensuring that the workforce comprises highly skilled and qualified staff in charge of airline operations. The other non-technical staff will be hired by the Human Resources department in consultation with the respective department heads.

However, Mr. Tan was well aware of the key factors required for success in the airline industry. He understood that one essential aspect was routes, and he knew that his main hub in Mumbai would only make sense if he secured a set of routes from Mumbai; otherwise, it would be catastrophic for the airline due to the high parking costs at Mumbai Airport. Being new to the Airlines of India, Mr. Tan was not familiar with all the laws but was determined to achieve his goals. He was aware that the renowned airline, TruJet Airways which had major routes originating from Mumbai, was undergoing insolvency due to running in losses and default in payment to secured creditors including in payment of current dues for the right to use the property in possession at Mumbai Airport.

Consequently, Mr. Tan hired the best lawyers in town to acquire their slots. The lawyers immediately approached the DGCA and requested the reallocation of these rights to them. They argued that TruJet is not entitled and had no right to use. They claimed that this was a breach of TruJet's operating conditions with the DGCA, as no other Airlines were allotted and permitted to use. So requested that the slots should be immediately handed over for consumer welfare. The DGCA agreed and handed over the slots to TAPL.

TruJet was offended by this order and approached the Apex court, claiming it was unjust. It argued that no one, including the regulators, has the right to take possession of any property from an owner or lessor in possession of the Corporate Debtor. DGCA countered that they had not initiated any new proceedings and that it was a matter of breach of contract; hence, the DGCA had the right to refuse the Right of use to TruJet.

I. Multiple Choice Questions

1. On April 30th 2024, Power Group Ltd. (PGL) sells an aircraft that it owns to Thunderbolt Airlines Private Limited (TAPL). This aircraft is of an older model. Therefore, its fair value is ₹ 45 crores while the carrying cost in PGL's latest books is ₹ 50 crores. How will PGL account for the loss in its books?

   (a) Recognize a loss of ₹ 5 crores in its books

   (b) Recognize a loss of ₹ 3 crores in its books

   (c) Recognize a loss of ₹ 2 crores in its books

   (d) Will not recognize a loss as the books will be consolidated at the year end

2. Which type of product would the premium economy seats be considered as?

   (a) Revolutionary product

   (b) Evolutionary product

   (c) Me-too product

   (d) Perishable product

3. Which of the following will not be true regarding the accountability in performance measurement system for the Human Resource department at TAPL?

   (a) Maintaining staff attrition below the threshold level would be hard accountability for the Human Resource department

   (b) Ensuring that employee payout and benefits are within budgeted limits would be a hard accountability for the Human Resource department

   (c) Addressing employee concerns about working environment would be a soft accountability for the Human Resource department

   (d) Ensuring synergy between the work cultures of executives of PGL and AAI deputed at TAPL by arranging for team building exercises would be hard accountability for the Human Resource department

4. TAPL has the identified the following critical success factor (CSF) "Enhance customer experience by maintaining the best on-time performance within the industry"

   Which one of the following would be the most suitable key performance indicator for this CSF?

   (a) Reduce the number of customer complaints regarding flight delays by 25%

(b) Reduce the average time taken to deal with complaints regarding flight delays by 20%

(c) Keep log / record of flight on time performance

(d) Increase the training for customer facing staff like those at the check-in counters, staff assisting boarding and the aircraft cabin crew

5. Mr. Tan texted the CFO of the company about the recent efforts to acquire those slots and asked for his opinion on what the outcome might be. The CFO then sent you an email asking you to analyze what verdict the Apex Court could deliver.

(a) As a regulator, the DGCA was well within its powers to transfer the right of use, and did not breach the Insolvency and Bankruptcy Code, 2016 due to default in payment of current dues arising for the use of possession of Mumbai airport.

(b) As a regulator, the DGCA was well within its powers to transfer the right of use, but it breached the Insolvency and Bankruptcy Code, 2016.

(c) The DGCA has no right to reallocate the rights because the airline was paying their current dues. However, they did not breach the Insolvency Bankruptcy Code, 2016 during the hearing of TAPL's petition.

(d) The DGCA had no right to reallocate the rights because the airline was paying their current dues, but it breached the Insolvency and Bankruptcy Code, 2016 during the hearing of TAPL's petition.

II. Descriptive Questions

6. AAI plans to enter into a joint venture with PGL from 1st April, 2024. TAPL is new vehicle for this purpose. What role internal audit function can play in such a joint venture?

7. Assess each of the hard and soft elements based on the McKinsey 7s Framework.

ANSWERS TO THE CASE STUDY 47

I. Answers to the Multiple Choice Questions

1. (a) Recognize a loss of ₹ 5 crores in its books

Reason: Recognize a loss of ₹ 5 crores in its books. As per Ind AS 28, Investment in Associates and Joint Ventures, the sale of aircraft by PGL to TAPL will be a downstream transaction where the investor sells the asset to the joint venture. There has been an impairment loss of ₹ 5 crores in the value of the aircraft since the fair value is less than the carrying value of the asset. As per para 29 of Ind AS

28, in case of downstream transactions where there has been an impairment in the net realizable value of the asset, the loss should be recognized in full by the investor. Therefore, the entire loss has to recognized by PGL, who is the investor in TAPL.

2. (b) Evolutionary product

Reason: Evolutionary product. Premium economy are an upgraded version of economy seats which currently form 95% of the seating capacity within the domestic aviation market. Premium economy offers few upgraded services and facilities as compared to the economy seats for a slightly higher charge. Hence, they have evolved out the economy seat concept, with few additional features. At the same time premium economy are not as niche in terms of their service as full premium seats.

3. (d) Ensuring synergy between the work cultures of executives of PGL and AAI deputed at TAPL by arranging for team building exercises would be hard accountability for the Human Resource department

Reason: The correct answer is (d) Ensuring synergy between the work cultures of executives of PGL and AAI deputed at TAPL by arranging team building exercises would be soft accountability for Human Resources department. Team building exercises to build synergy is human input in the system that cannot be objectively measured and is essentially intangible in nature. Hence from a performance management perspective, it is a soft measure.

The other measures are either financial or quantitative information which can be measured.

4. (a) Reduce the number of customer complaints regarding flight delays by 25%

Reason: since reduction in the number of complaints will be definitively indicative of achievement of on time performance

Reduction in time taken to attend customer complaints, record of on time performance or increased staff training do not necessarily indicate the achievement of the best on time performance within the industry.

5. (a) As a regulator, the DGCA was well within its powers to transfer the right of use, and did not breach the Insolvency and Bankruptcy Code, 2016 due to default in payment of current dues arising for the use of possession of Mumbai airport.

Reason: According to Section 14 of the Insolvency and Bankruptcy Code, 2016, the institution of suits and continuation of pending proceedings against a Corporate Debtor in any court is not allowed during the period of moratorium.

However, the DGCA had not instituted any suit to reallocate the right; hence, they did not breach the Insolvency and Bankruptcy Code.

Furthermore, Section 14 explicitly states that a license, permit, registration, or similar grant or right issued by the Central Government, State Government, local authority, or sectoral regulator shall not be suspended or terminated on the grounds of insolvency, provided there is no default in the payment of current dues arising from the use of such license or grant during the moratorium.

The DGCA has right to reallocate the rights to use due to default of the current dues by Trujet. However, DGCA did not breach the Insolvency and Bankruptcy Code, 2016 during the hearing of TAPL's petition.

II. Answers to the Descriptive Questions

6. The internal audit can play an important role in joint venture in assessing key governance risks. Such risks in a joint venture may include: -

- Establishing joint venture strategy and its monitoring
- Issues in capital planning
- Controls governing investments in joint venture
- Division of governance functions and consequent delegation of authority
- Agreement between both the stakeholders on key governance matters

The purpose of a joint venture is sharing risks and rewards in developing new market for "premium economy" segment in India. A joint venture involves joint control of a business with contribution of resources by investors to run it.

Internal audit provides independent assurance on effectiveness of internal controls and risk management processes to enhance governance and achieve organisational objectives. In fact, internal audit can help an organisation in achieving its objective without compromising upon its independence. It includes review of operational activities, underlying internal controls and compliance with applicable laws and regulations.

Therefore, internal audit function can play a critical role in joint venture like TAPL.

7. AAI and PGL will benefit from the McKinsey 7s framework as it is undergoing substantial change in its operations by entering the Indian aviation sector. There are 3 hard elements – Strategy, Structure and Systems and 4 soft elements – Shared values, Style, Staff and Skills. Each of these elements represent a constellation of systems, which when

integrated well assist in effective implementation of strategies, efficient use of resources and ultimately enables the organization to create value. The hard elements can be easily quantified, defined, and influenced by the management while the soft elements are those that are influenced by culture within an organization, making them intangible in nature and therefore relatively difficult for the management to influence. It is important for TAPL to have properly integrated systems in place in order to execute its strategies well in the highly competitive aviation industry. It is a Joint Venture between two globally established, reputed organizations and therefore this framework will help the organization identify any blind spots at the inception stage itself.

Strategy

- TAPL strategically positions itself in the "premium economy" segment to capture a unique market niche, leveraging Avain Airlines' premium services and PGL's extensive market presence.
- It differentiates by offering superior service at slightly higher rates than economy, aiming to attract business travellers and price-sensitive premium customers.
- The partnership with AAI enhances global connectivity, a key differentiator in the competitive Indian aviation market.

Structure

- The joint venture's structure, with PGL's majority and AAI's strategic stake, balances expertise and control, optimizing the organizational workflow.
- Initially centralized under COO Mr. Tan for coherent early decision-making, with a view to evolve towards flexibility and scalability as TAPL grows.
- Functional departmentalization harnesses AAI's aviation expertise and PGL's market insight, fostering efficiency and market responsiveness.

Systems

- Digitalization and technology adoption streamline operations and improve customer satisfaction, positioning TAPL for operational excellence.
- Strategic implementation of advanced reservation and CRM systems underpins competitive advantage through enhanced efficiency and service personalization.
- Clear goals and performance measurement for each department ensure aligned and efficient operational execution.

Style

- Leadership style integrates AAI and PGL's diverse cultures, promoting innovation, agility, and a unified approach towards strategic goals.
- Emphasizes a corporate culture of creativity, motivation, and customer-centricity, crucial for navigating the dynamic aviation sector.
- Cross-functional teams foster collaboration and a shared vision, enhancing TAPL's strategic and operational agility.

Staff

- TAPL's strategic talent management focuses on diversity, competitive remuneration, and professional growth to mitigate industry-high attrition rates.
- A supportive work environment and opportunities for development aim to attract and retain a motivated workforce.
- Recognizes staff as crucial for delivering the high service standards expected in the premium economy segment.

Skills

- Collaborative training and continuous learning initiatives ensure the workforce is equipped with necessary technical and soft skills.
- Balanced focus on operational safety and customer service excellence supports TAPL's differentiation strategy.
- Continuous investment in staff development ensures alignment with TAPL's premium service ethos and brand promise.

Shared Values

- TAPL's core values of honesty, work ethic, transparency, accountability, and trust underpin its operations and customer interactions. These values are central to building a strong, customer-focused brand identity and fostering loyalty in the competitive aviation sector.
- Aligning strategic and operational practices with these shared values ensures TAPL's market positioning and brand strength.

CASE STUDY 48

Manpower Services Private Limited is a subsidiary of a Singapore based Company. The Company has received a land on lease for 99 years from the Government to carry out its activities. At the inception of the lease, the land is utilised by the company and a building has been constructed. As per the terms and conditions of the lease, the Company is supposed to return the land to the Government after 99 years on a "as it is where it is basis".

The Company has entered into secondment agreements of employees with group companies located in USA, UK, Dublin, Singapore etc. Key terms and conditions of the agreement are as follows:

- When required, the Indian Company requests foreign Group companies for managerial and technical personnel to assist in its business. Accordingly seconded employees are selected by foreign Group company and are transferred to the Indian Company.
- During the term of secondment, the seconded employee would act in accordance with the instructions and directions of the Indian Company. The seconded employees would devote their entire time and work to Indian Company.
- The seconded employees would continue to be on the payroll of the foreign group company for purpose of continuation of social security/ retirement benefits, but for all practical purposes, Indian Company would be the employer.
- The seconded employees would receive the salary, bonus, social benefits, out of pocket expenses and other expenses from foreign group company and the foreign group company would raise debit note on the Indian Company to recover the said expenses without any mark-up.

The Company is registered with GST authorities under the categories of 'manpower recruitment agency service'. During an audit, the GST department contended that the seconded employee cannot be called as employee of Indian Company and there cannot be any relief from payment of GST under reverse charge. The authorities alleged that the Indian Company has failed to pay GST under reverse charge for the services of manpower supply received from the foreign group entities. Accordingly, a demand for unpaid amount of GST, interest and penalty was raised on the Indian Company.

The CFO informed the Board of Directors regarding the above demand. The Board of Directors enquired about the financial position of the company as of the end of the year to assess the potential implications. Following is the summary of the financial position at the year-end, prepared as per Accounting Standards issued under Companies (Accounting Standards) Rules, 2021:

INR crores

Profit and Loss Account		
	Current year	Previous year
Revenue	50	40
Expenses	10	15
Profit after tax	40	25

Balance sheet		
	Current year	Previous year
Total assets	900	1,000
Equity	400	600
Total liabilities (including third party loan of INR 10 crores in current year and INR 5 crores in previous year)	500	400

The CFO also mentioned that the financial statements and annual return of the previous year have not yet been filed by the Company. Basis the above financial information, the CFO note that the Company meet the exemption criteria as available to a private company and accordingly the Company would be exempted from audit of internal financial control with reference to financial statements as prescribed under section 143(3)(i) of the Companies Act, 2013. In the Board meeting the CFO also mentioned that UK is strengthening its data privacy norms thereby significant investment would be required to overhaul the internal controls for ensuring compliance with the amended data protection norms. Non-compliance would lead to significant punitive damages on the Company/ directors. The Board decided that considering the cost benefit, it would be prudent to exit the UK jurisdiction. The Board authorised the Managing Director to initiate the next steps.

The Managing Director also informed the Board that the Company have been hit by a series of cyber security incidents that has impacted some of its valued stakeholders and their personal information. These cyber incidents resulted in an unauthorised third-party gaining access to the Company's data systems. The Company had provided necessary intimations to the Regulatory authorities. Once aware of the unauthorised access to data, the Company worked urgently to contain the threat and investigated what occurred. The Company also engaged external cyber security experts to assist with their response to the incident and to ensure the ongoing safety and security of its systems. It has been identified that only the following types of personal information are likely to have been extracted by unauthorised third party. Investigations have confirmed that no bank account was included in the affected files.

Sr. No	Type of cyber attack	Type of information expected to be leaked				Total
		Surname	Pin code	Email address	Date of birth	
1	**Malware** — or malicious software — is any program or code that is created with the intent to do harm to a computer, network or server.	2	5	1	-	8
2	**Denial-of-Service** attack is a malicious, targeted attack that floods a network with false requests in order to disrupt business operations.	3	2	20	5	30
3	**Phishing** is a type of cyberattack that uses email, SMS, phone, and social media to entice a victim to share sensitive information	7	-	5	5	17
4	**Spoofing** is a technique through which a cybercriminal disguises themselves as a known or trusted source.	10	10	-	-	20
5	**Identity-driven attacks** - a valid user's credentials have been compromised and an adversary is masquerading as that user.	5	-	1	-	6
6	**Supply chain attack -** targets a trusted third-party vendor who offers services or software vital to the supply chain.	-	2	1	1	4
	Total	**27**	**19**	**28**	**11**	**85**

Further, following general precautionary steps to reduce the risk of harm in future:

- Remain alert to increased scam activity or any unsolicited communications via email, SMS or phone.

- Do not click on any suspicious links or provide your passwords or any personal information.
- Consider changing your online account passwords.

I. Multiple Choice Questions

1. The management estimated that INR 10 crores would be incurred at the end of 99 years to dismantle/ demolish the building and return the land to the Government. Accordingly provision was recognised by adding to the corresponding item of property, plant and equipment. Is the accounting treatment appropriate?

   (a) Yes– Under IND AS 37, provision should not be discounted to its present value.

   (b) No– Under IND AS 37, provision for decommissioning, etc that has material effect on the time value of money should be discounted to its present value.

   (c) No– Under IND AS 37, provision for decommissioning, etc should have been recognised as an expense in the Profit and Loss Account.

   (d) Yes– Under IND AS 37, provision should not be discounted to its present value. However, the provision should have been recognised as an expense in the Profit and Loss Account.

2. The management proposes to appoint the auditor to design and implement financial information system of the Company. Can the auditor accept such engagement?

   (a) No– Since an auditor cannot design and implement financial information system of any audit client as such service is prohibited under section 144 of the Companies Act, 2013.

   (b) Yes– Since the auditor is prohibited from designing and implementing financial information system of a listed audit client as provided under section 144 of the Companies Act, 2013.

   (c) Yes– Since the auditor of a private limited company is permitted to design (but not implement) financial information system as provided under section 144 of the Companies Act, 2013.

   (d) No. Since the auditor of a private limited company is specifically prohibited under Section 144 to the Companies Act, 2013 to assume a management responsibility.

3. The auditor of the Company has initiated audit planning discussions with the management. The management informed that the audit of internal control with reference to financial statements is not applicable considering that the Company meet the exemption criteria provided by MCA for certain private company. The auditor believes that audit of the internal controls would be required. Do you agree with the auditor?

(a) No. The exemption criteria are met. Non-filing of financial statements is not relevant.

(b) No. The exemption criteria are met. Non-filing of Annual Return is not relevant.

(c) Yes. No exemption has been prescribed under the Companies Act, 2013 in respect of internal control with reference to financial statements of private/ public companies.

(d) Yes. The exemption criteria are not met since the Company has committed a default in filing financial statements/ Annual Return.

4. From the perspective of risk management, the Company is facing risk in UK jurisdiction?

(a) Strategic.

(b) Operational

(c) Compliance

(d) Financial.

5. The Company plans to use Pareto's analysis. Which of the following statement is the correct description of this concept?

(a) Commonly known as the 80:20 Rule states that for many outcomes, roughly 20% of consequences come from 80% of causes.

(b) Commonly known as the 80:20 Rule. It is a fixed % Rule.

(c) Commonly known as the 80:20 Rule states that for many outcomes, roughly 80% of consequences come from 20% of causes.

(d) Commonly known as the 80:20 Rule. It is a detective mechanism and not a control mechanism.

II. Descriptive Questions

6. Perform Pareto Analysis of total cyber incidents and the type of data leakage using the above and provide recommendations to the management of the Company.

7. The CFO is unsure whether the secondment arrangement fall under the purview of the Goods and Services Tax Act, 2017 and accordingly whether a provision should be recognised as at the end of the year. Describe the accounting scenarios that are possible under Ind AS 37 for recognition of the demand?

ANSWERS TO THE CASE STUDY 48

I. Answers to the Multiple Choice Questions

1. **(b)** No– Under IND AS 37, provision for decommissioning, etc that has material effect on the time value of money should be discounted to its present value.

Reason: Para 45 of Ind AS 37 States that:

Where the effect of the time value of money is material, the amount of a provision shall be the present value of the expenditures expected to be required to settle the obligation.

2. **(a)** No– Since an auditor cannot design and implement financial information system of any audit client as such service is prohibited under section 144 of the Companies Act, 2013.

Reason: Section 144 to the Companies Act, 2013 prohibit auditor to directly/ indirectly design and implement financial information system of a company, its holding or subsidiary company.

3. **(d)** Yes. The exemption criteria are not met since the Company has committed a default in filing financial statements/ Annual Return.

Reason: Refer MCA notification dated 5 June 2015 which provide that In case of Private Company section 143(3)(i) would not apply to:-

(i) which is a one person company or a small company; or

(ii) which has turnover less than rupees fifty crores as per latest audited financial [statement and] which has aggregate borrowings from banks or financial institutions or any body corporate at any point of time during the financial year less than rupees twenty five crore.

The exceptions, modifications and adaptations shall be applicable to a private company which has not committed a default in filing its financial statements under section 137 of the said Act or annual return under section 92 of the said Act with the Registrar.

4. **(c)** Compliance

Reason:*Compliance risk is the potential damage businesses face when they fail to comply with industry standards, laws, and regulations. This risk involves both financial penalties and reputational damage.*

5. **(c)** Commonly known as the 80:20 Rule states that for many outcomes, roughly 80% of consequences come from 20% of causes.

II. Answers to the Descriptive Questions

6. The Pareto Principle is a concept that specifies that 80% of consequences come from 20% of the causes, asserting an unequal relationship between inputs and outputs. It is not a fixed percentage rule. In a general sense, it means that a few products/ services can make up most of the value of an entity. Named after economist Vilfredo Pareto, the Pareto Principle serves as a general reminder that the relationship between inputs and outputs is not balanced. The Pareto Principle can be applied in a wide range of areas such as manufacturing, management, and human resources. The Pareto Principle is even more applicable to businesses that are client-service based and has been adopted by a variety of customer relationship management software programs.

In the present case the Denial of Service incidents are the most common cyber incidents encountered by the Company and represented 35% of the total number of cyber incidents. Spoofing , Denial-of-Service attack and Phishing accounted for 79% of the total cyber attacks. Refer computation below:

Pareto Analysis of total cyber incidents	Nos	% total	Cumulative %
Denial-of-Service attack	30	35	35
Spoofing	20	24	59
Phishing	17	20	79
Malware	8	9	88
Identity-driven attacks	6	7	95
Supply chain attack	4	5	100
Total	**85**		

So these are considered as key incidents and the Company must allocate resources to mitigate these threats. Else, the Company might face implications and loose reputation in the market.

Further, a second level Pareto analysis reveal that that the email address was the common data that got leaked. Email address and Surname together accounts for 64% of the type of data leakage. So, the Company must direct its efforts and develop specific controls to safeguard this information and avoid the data leakage in future.

Pareto Analysis of type of data leakage	Nos	% total	Cumulative %
Email address	28	33	33
Surname	27	32	65
Pincode	19	22	87
Date of birth	11	13	100
Total	**85**		

7. Ind AS 37 applies to the accounting for provisions, contingent liabilities and contingent assets. A provision is recognised when (a) a present obligation as a result of a past event exists; (b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and (c) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision should be recognised. In almost all cases it will be clear whether a past event has given rise to a present obligation. In rare cases, for example in a legal demand, it may be disputed either whether certain events have occurred or whether those events result in a present obligation.

Regarding the demand received for GST, the Company should determine whether a present obligation exists at the balance sheet date by taking account of all available evidence. Further information might become available between the balance sheet date and the date on which the Company's financial statements are finalised. Where this happens, that information should be taken into account in determining whether or not a present obligation exists at the balance sheet date. For example, the Company should assess whether any clarifications, etc have been issued by the GST department or any judgements have been passed by Supreme Court which lays down the principal in this regard. To seek more clarity on this matter the Company may obtain opinion of legal experts and assess the appropriateness of the rational for reaching the position.

On the basis of the evidence the Company should decide the following regarding the GST demand received:

- Where it is more likely than not that a present obligation exists at the balance sheet date: Ind AS does not put a numerical measure of probability but requires management to assess the likelihood of occurrence basis facts and circumstances. This implies where the outflow of resources is more likely than not to occur (that is, the probability of occurring is greater) a provision would be required under Ind AS 37. Accordingly in this scenario, the Company should recognise a provision (if the recognition criteria are met) for the estimated amount of GST liability.
- Where it is more likely that no present obligation exists at the balance sheet date: The Company should disclose a contingent liability regarding the amount of estimated GST liability, unless the possibility of an outflow of resources embodying economic benefits is remote.

CASE STUDY 49

CA. M has a flourishing practice spanning in areas of auditing, taxation (both direct as well as indirect), consultancy (particularly in foreign exchange laws) in Chennai. His clients include many HNIs (High net worth individuals) apart from corporates and non-corporates.

One day, one of his HNI clients, Mr. P, called him to inquire about tweaking of certain rules pertaining to taxation on redemption of mutual fund investments. He had heard that redemption for certain types of mutual fund investments is now going to attract increased income tax payouts. He had also heard news of the same on BTBC news channel but was unable to comprehend it lucidly. There was no clarity to him whether changes have been made in income tax law or in rules framed by SEBI.

Rely Consultancy, an AMFI registered mutual fund distributor through which MF investments were made, was continuously forwarding messages received from AMFI (Association of Mutual Funds in India) to his mobile. The messages were, at the best, cryptic and required investors to be in touch with their Chartered Accountants/tax consultants.

Mr. P had an impressive investment portfolio of around ₹ 50 crores in various mutual funds and any changes in income tax payouts pertaining to it could affect his ROI adversely. Under stress, he sought for an immediate appointment with CA M. Armed with summary of investments made in mutual funds, he came to CA's office and sought his much-needed advice. The summary of mutual fund investments as on 31st March, 2023 looked as under: -

S.No.	Type of fund in which money invested	Date of Investment	Amount invested (in ₹ crores)
1	MTL Low Duration Fund	3/4/2020	10
2	Bon India Low Duration Fund	12/12/2020	15
3	ABD New Green Energy Fund	2/12/2022	15
4	SBA Life Arbitrage Fund	8/11/2021	10

Besides, he had also invested ₹ 5 lacs in a liquid fund. Since amount invested was small, he was not bothered about the same.

He also informed to CA M that funds stated at 1 and 2 are debt funds and funds stated at 3 and 4 are equity funds. He further informs that these debt funds have invested 30% of their proceeds in equity shares of domestic companies and equity funds have invested 70% of their proceeds in equity shares of domestic companies. The investment pattern of funds is going to remain unchanged in coming years too. He was planning to redeem his entire mutual fund

investment portfolio in month of October 2023 tentatively depending upon suitable market conditions.

Their discussion also veered towards returns from debt funds. Debt funds invest predominantly in government and high-grade corporate bonds. Mr. P was of the view that interest rates in economy are likely to go up in few months' times keeping in view broad macroeconomic indicators.

The discussion stretched a bit and it came out that he plans to buy a villa in Goa. He is already 65 and wants to spend quality time in scenic beauty of Goa. In fact, it transpires that he is going to make an advance payment of ₹ 1.00 crore to owner of villa, Mr. Christopher, an Indian citizen who is non-resident. The non-resident owner of villa had acquired this ancestral property through registered will of his late father. The total consideration to be paid to Mr. Christopher amounts to ₹ 5 crores (including advance payment of ₹ 1 crores).

In fact, it is also one of the reasons for planned redemption of MF investments in current financial year. He enquires from CA M regarding any precautions to be taken/legal requirements to be complied with at the time of entering such transaction. Mr. P also discusses the matter with said Mr. Christopher over phone who happens to be in India at that time for a short visit. He, in turn, also enquires from CA M regarding investment avenues, if any available to non-residents like purchase of other house/investments in NHAI bonds, under taxation laws to save capital gains tax and other requirements pertaining to filing of income tax return. It also transpires that India does not have any DTAA with the country of which Mr. Christopher is a resident.

Mr. Christopher plans to repatriate proposed sale proceeds of villa to the country in which he is resident. He does not know about modalities of the same and inquires from CA M in this matter.

I. Multiple Choice Questions

1. Mr. P has invested ₹ 10 crores in SBA Life Arbitrage fund. Which of the following statements is most appropriate about arbitrage funds?

   (a) Such funds tend to provide better returns than equity. However, they have lower volatility in comparison to equity. Besides, they seek to capitalize on price differential between spot and futures market. Expense ratios in arbitrage funds are likely to be lower as compared to liquid funds.

   (b) Such funds tend to provide better returns than debt instruments. However, they have higher volatility in comparison to equity. Besides, they seek to capitalize on

price differential between spot and futures market. Expense ratios in arbitrage funds are likely to be higher as compared to liquid funds.

(c) Such funds tend to provide better returns than debt instruments. However, they have lower volatility in comparison to equity. Besides, they seek to capitalize on price differential between spot and futures market. Expense ratios in arbitrage funds are likely to be higher as compared to liquid funds.

(d) Such funds tend to provide better returns than equity. Therefore, they have higher volatility in comparison to equity. Besides, they do not seek to capitalize on price differential between spot and futures market. Expense ratios in arbitrage funds are likely to be lower as compared to liquid funds.

2. Mr. P is of the view that interest rates in economy are likely to rise. What likely impact it would have on NAV of debt fund? (Ignore other factors like duration of bonds etc.)

(a) It is likely to lead to fall in NAV of debt fund.

(b) It is likely to lead to rise in NAV of debt fund.

(c) NAV of debt fund is likely to remain at past level.

(d) NAV of debt fund is not affected by movement in interest rate.

3. As regards proposed purchase of villa in Goa from Mr. Christopher is concerned, which of the following statements is likely to be correct as regards deduction of tax at source (TDS) is concerned? Assume he does not have any other taxable income in India except capital gain from proposed sale of villa. Ignore surcharge and cess.

(a) Mr. P is required to obtain TAN. TDS is required to be deducted @ 1% of ₹ 5 crores. Entire TDS can be deducted at time of/before registration of title deed.

(b) It is not mandatory for Mr. P to obtain TAN. TDS is mandatorily required to be deducted @20% on ₹ 5 crores. However, TDS would be deducted at time of making advance payment as well as at time of making balance payment.

(c) It is not mandatory for Mr. P to obtain TAN. An application can be made to Assessing Officer for determining capital gains on which tax is to be deducted. In that case, TDS would be deducted at lower rate after determination of capital gains by AO in the international wing. If lower deduction certificate is not available, TDS would be deducted at maximum marginal rate of 30% on ₹ 5 crores. However, TDS would be deducted at the time of making advance payment as well as at time of making balance payment.

(d) Mr. P is required to obtain TAN. An application can be made to Assessing Officer for determining capital gains on which tax is to be deducted. In that case, TDS would be deducted at lower rate after determination of capital gains by AO in the international wing. If lower deduction certificate is not available, TDS would be deducted at 20% on the amount determined by the AO. However, TDS would be deducted at the time of making advance payment as well as at time of making balance payment.

4. As regards Mr. Christopher's enquiry regarding purchase of another residential property In India and investment in bonds of NHAI (National Highways Authority of India) and filing of income tax return, which of following statements is most appropriate? (Ignore issue of refund arising on account of TDS deduction for return filing.)

(a) Non-residents can make above said investments to save capital gains tax. However, after making investments, if he has no taxable income, there is no legal obligation to file income tax return.

(b) Non-residents can make above said investments to save capital gains tax. However, if his total income before giving effect to deduction against such investments exceeds basic exemption limit, there is legal obligation to file income tax return.

(c) Non-residents cannot make above investments to save capital gains tax. Such investments can be made by residents only to save capital gains tax. Therefore, question of obligation of filing of return would become superfluous as he would be compulsorily required to file income tax return showing taxable income from sale of villa.

(d) Non-residents can make investments by purchase of another residential property in India but cannot make investments in bonds of NHAI which can be subscribed by residents only. Therefore, filing of return would depend upon whether he has taxable income left after investing in residential house property.

5. Mr. Christopher plans to repatriate from India sale proceeds of villa. Which of the following statements is most appropriate in this regard?

(a) Proceeds up to USD 250000 can be repatriated in a financial year by using Liberalised Remittance Scheme (LRS) as it is a capital account transaction falling under the scheme.

(b) Proceeds up to USD 250000 can be repatriated in a calendar year by using Liberalised Remittance Scheme (LRS) as it is a capital account transaction falling under the scheme.

(c) Proceeds can be repatriated using NRO account subject to certain restrictions in a financial year.

(d) Proceeds up to USD 200000 can be repatriated in a financial year by using Liberalised Remittance Scheme (LRS) as it is a capital account transaction falling under the scheme.

II. Descriptive Questions

6. Since Mr. P wants to redeem his entire portfolio in month of October 2023, what should be the advice of CA. M to him regarding income tax implications of such redemption? (Do not calculate income tax liability in each case. Just describe manner of taxation and rates. Ignore surcharge and cess). What further advice he should offer regarding news heard on TV/messages received on mobile?

7. Mr. P has also plan to invest further amount of ₹ 10 crores in MTL Low Duration Fund and Bon India Low Duration Fund taken together in F.Y. 2023-24. What are tax implications on redemption of above investment after holding it for more than 3 years down the line? (Assume that tax law as applicable in F.Y. 2023-24 remains unchanged at time of redemption).

8. Mr. Christopher, a non-resident, is planning to sell his villa in Goa. Examine validity of transaction w.r.t FEMA, 1999.

ANSWERS TO THE CASE STUDY 49

I. Answers to the Multiple Choice Questions

1. (c) Such funds tend to provide better returns than debt instruments. However, they have lower volatility in comparison to equity. Besides, they seek to capitalize on price differential between spot and futures market. Expense ratios in arbitrage funds are likely to be higher as compared to liquid funds.

Reason: Arbitrage funds provide better returns than debt instruments as they work on the principle of capitalizing price differential between spot and futures market. Equities are riskiest and obviously have high rate of returns. However, arbitrage funds have lower volatility as compared to equity.

Typically, expense ratios in arbitrage funds are likely to be higher as compared to liquid funds. Since arbitrage funds would carry large number of trades to capitalize price differential between different markets, expense ratios tend to be higher as compared to liquid funds. Liquid funds invest in highly liquid money

market instruments and debt securities of short tenure which are normally held till maturity resulting in lower expenses.

2. (a) It is likely to lead to fall in NAV of debt fund.

Reason: Debt funds invest in government bonds/securities, high grade corporate bonds etc. There is inverse relationship between market value of bond and interest rates. As interest rate goes up, market value of bond falls and vice-versa. In economic conditions of rising interest rates, people would be unwilling to buy bonds carrying lower interest rates issued previously. Therefore, price of bond falls exhorting people to buy such bonds which were issued at a lower coupon rate. It, in turn, leads to fall in NAV.

3. (d) Mr. P is required to obtain TAN. An application can be made to Assessing Officer for determining capital gains on which tax is to be deducted. In that case, TDS would be deducted at lower rate after determination of capital gains by AO in the international wing. If lower deduction certificate is not available, TDS would be deducted at 20% on the amount determined by the AO. However, TDS would be deducted at the time of making advance payment as well as at time of making balance payment.

Reason: Tax on purchase of immovable property from non-resident owner is deducted u/s 195 of Income Tax Act, 1961 where the deductor is required to obtain TAN. There is no DTAA agreement with overseas country in which Mr. Christopher is residing. TDS would be deducted @20% on ₹ 5 crores. However, application can be made to AO u/s 195(2) or 197 for determination of capital gains on which tax is to be deducted and the rate of TDS, respectively. In that case, tax would be deducted at lower rate on the amount determined by the AO. Tax is deducted u/s 195 at the time of credit of such income to the account of payee or at the time of payment, whichever is earlier. Therefore, TDS deduction is required at time of paying advance as well as at the time of making balance payment.

4. (b) Non-residents can make above said investments to save capital gains tax. However, if his total income before giving effect to deduction against such investments exceeds basic exemption limit, there is legal obligation to file income tax return.

Reason: Non-residents can make investments by purchasing another residential property u/s 54 and/or by purchasing bonds of NHAI in accordance with provisions of section 54EC. There is no bar in these sections for investments to be made by Non-residents.

Under section 139 of Income-tax Act, 1961, every person, if his total income without giving effect to the provisions of section 54 or section 54B or section 54D or section 54EC or section 54F or section 54G or section 54GA or Chapter VI-A exceeded the maximum amount which is not chargeable to income-tax, shall, on or before the due date, furnish a return of his income. Therefore, there is a legal obligation to file the return when total income before giving effect to deduction u/s 54 & 54EC exceeds basic exemption limit.

5. **(c)** Proceeds can be repatriated using NRO account subject to certain restrictions in a financial year.

Reason: Liberalised Remittance Scheme is available for resident individuals only. Sale proceeds of villa would be repatriated by non-resident Mr. Christopher using NRO account subject to certain restrictions in accordance with relevant guidelines laid down by RBI under FEMA,

II. Answers to the Descriptive Questions

6. MTL Low Duration Fund and Bon India Low Duration Fund are debt funds. However, in case of MTL Low Duration Fund, holding period would likely to be more than 36 months. It would qualify as a long- term capital asset by virtue of provisions of 2(29AA) and 2(42A) of Income-tax Act, 1961. Therefore, long term capital gain would arise on redemption of units of this fund. Indexation benefit would be available and long- term capital gain would be taxable @ 20% u/s 112 of Income-tax Act, 1961.

In case of Bon India Low Duration Fund (another debt fund), holding period would likely to be less than 36 months. Therefore, short term capital gains would arise on redemption of units of this fund. Short-term capital gain would arise on redemption of these units taxable at normal rates of tax applicable to Mr. P. There is no special rate for short term capital gain on debt funds.

ADB New Energy Green Fund is an equity- oriented fund as it has invested more than 65% of its proceeds in equity shares of domestic companies. Short-term capital gains would arise due to redemption of units of this Fund in month of October 2023 as holding period would be less than 12 months in accordance with provisions of section

2(42A) of Income-tax Act, 1961. Such short-term capital gains of equity-oriented funds would be taxable @15% u/s 111A of Income-tax Act, 1961.

SBA Life Arbitrage Fund is also an equity-oriented fund just like ADB New Energy Green Fund. However, long term capital gains would arise on redemption of units of this fund as holding period would be more than 12 months. Such long- term capital gains would be taxable @10% u/s 112 A of Income-tax Act, 1961 exceeding ₹ 1 lakh.

CA M should inform Mr. P that there is no change in taxation pertaining to redemption of his investment portfolio as it stood on 31st March, 2023 and these would continue to be taxed as discussed above. The news/messages received by him are applicable to investments made on or after 1st April, 2023.

7. Both MTL Low Duration Fund and Bon India Low Duration Fund have invested 30% of their proceeds in equity shares of domestic companies. Finance Act, 2023 has introduced new section 50AA which states that capital gains arising on redemption of units of a Specified Mutual Fund which has been acquired on or after 1st April, 2023 shall deemed to be arising from transfer of a short-term capital asset. Specified Mutual Fund is a mutual fund which invests not more than 35% of its total proceeds in the equity shares of domestic companies.

Therefore, if Mr. P redeems his proposed investment even holding it for a period of more than 3 years down the line, indexation benefit would not be available to Mr. P and such income would be deemed as short-term capital gains and it would be taxable in accordance with slab rates applicable to him.

8. As per section 6(5) of the FEMA, 1999, a person resident outside India may hold, own, transfer or invest in Indian currency, security or any immovable property situated in India if such currency, security or property was acquired, held or owned by such person when he was resident in India or inherited from a person who was resident in India.

In the given case, villa at Goa was an ancestral property and was obtained through registered will of his father, who was an Indian resident. Sale of villa by a non-resident owner, is a valid transaction.

CASE STUDY 50

An article singing paeans for India's space-tech start-ups appeared in *"The New York Times"* recently. The article underlined that India has become home to many such start-ups. It pointed out that space technology is fulfilling smaller-scale and commercial purposes like helping farmers in timely insurance of their crops. Space technology is also helping commercial fishing fleets in tracking their catch by sending images back to Earth. Satellites are bringing phone signals to country's remotest corners and are helping in operation of solar farms far away from India's megacities. It's also one of India's most sought-after sectors for venture capital investors.

Start-ups are mushrooming in different sectors of India's economy as varied as education, health, agriculture, fintech, clean energy, electric vehicles, bio technology, waste management, food processing and even drones. *Economic Survey for year 2022-23* highlights that by capitalising on the digital infrastructure support, India has also emerged as one of the world's most vibrant destinations for start-up ecosystems. Start-ups are being envisioned as the spine of new India. In fact, India is home to world's third largest start-up eco system.

GrowFine is an ed-tech start-up incorporated as a private company in April 2023. The founders of start-up believe that some benefits are available to start-ups under income tax law. However, they are unaware about nitty-gritty of the same as they are from engineering and management backgrounds. The company had launched its products in year 2023-24 itself and had a turnover of ₹ 20 crores. It is recognized by DPIIT (Department for Promotion of Industry and Internal Trade under Ministry of Commerce and Industry) and holds a certificate of eligible business and is recognized as a technology driven start-up by competent authority.

GrowFine has issued shares to certain investors who are familiar with founders of this ed-tech start-up during year 2023-24. They believe in the business idea of founders of the company and have decided to invest money out of their own resources. These investors are wedded to idea of providing quality affordable education to all and promoting standards of education in the country. In this way, their ideological belief stands aligned with mission of founders of start-up.

The start-up GrowFine has issued equity shares having face value of ₹ 10/-per share to these individuals @ ₹ 50/-per share during year 2023-24. The fair market value of equity shares of start-up as on valuation date is ₹ 11/-per share. The existing paid up share capital of company is ₹ 1.50 crores. The company has not issued shares at premium anytime in past.

GrowFine is still in nascent stages. However, it has already launched its products and has entered a segment of the market. The market has a considerable potential for company's business to grow. Start-ups not only need finance but they also require favourable and conducive eco system to grow. It includes not only hand holding at time of germination of a

business idea but also policy measures having a legislative backing. In India, relaxations and benefits have been provided to start-ups under various laws like under Income tax Act,1961 and Companies Act,2013.

GrowFine needs talented and skilled employees for its business. However, the company is not in a position to pay high cash salaries to attract and retain employees. It is, therefore, considering route of employee stock option plans (ESOPs). Employee stock option plans provide a chance to employees to become shareholders in the company and also be benefitted by its future growth. The company plans to draft an ESOP scheme containing matters relating to grant of option, vesting period and manner of determining exercise price among others. The company is approaching many talented persons for assuming various senior roles in its organizational set-up. One such senior person, Mr. X, has shown interest in joining the company. However, he is sceptical regarding income tax implications pertaining to ESOPs. He has a doubt that it may lead to withholding of tax by start-up impacting his immediate "in-hand" salary.

GrowFine is planning to merge another start-up company engaged in similar line of activity to increase its size, revenue and scalability. However, founders of the company are clueless regarding modalities of the same under relevant laws.

Valuation of start-ups is often required for bringing in investments. The value of a start-up is dependent upon its future growth prospects. It is also quite likely that such a business idea has never been tested before. It only lies in realms of future. Another problem in start-up valuation is totally new or non-comparable business products and strategies. Start-ups also depend upon many rounds of funding. GrowFine may also approach another set of investors in further rounds of funding.

I. Multiple Choice Questions

1. From the description given in case study relating to finance brought by individuals from their own resources and whose belief in promoting affordable education to all in the country and also improving its standards is aligned with mission of founders, which type of financing for a start-up is being referred to?

   (a) Bootstrapping

   (b) Venture capital financing

   (c) Funding by angel investors

   (d) Factoring

2. The founders of GrowFine believe that some benefits are available to start-ups. Considering the description provided in case study, which of the following statements is in accordance with provisions of income tax law?

(a) Company is eligible to deduction @ 75% of its profits from eligible business for any 5 consecutive assessment years out of 10 years beginning from the year in which start-up is incorporated. Further, certificate of eligible business in this regard is provided by Inter-Ministerial Board for Certification.

(b) Company is eligible to deduction @ 100% of its profits from eligible business for any 3 consecutive assessment years out of 10 years beginning from the year in which start-up is incorporated. Further, certificate of eligible business in this regard is provided by Inter-Ministerial Board for Certification.

(c) Company is eligible to deduction @ 75% of its profits from eligible business for any 5 consecutive assessment years out of 10 years beginning from the year in which start-up is incorporated. Further, certificate of eligible business in this regard is provided by CBDT.

(d) Company is eligible to deduction @ 100% of its profits from eligible business for any 3 consecutive years out of 10 years beginning from the year in which start-up is incorporated. Further, certificate of eligible business in this regard is provided by CBDT.

3 As regards doubt of Mr. X regarding withholding tax in relation to ESOPs is concerned, which of the following statements is most appropriate?

(a) Income tax would be withheld at rates in force when option is exercised and shares are allotted to Mr. X.

(b) The company is an eligible start-up holding certificate of eligible business. Income tax would not be withheld when option is exercised and shares are allotted to Mr. X as such transactions are exempted from withholding tax in case of eligible start-ups.

(c) The company is an eligible start-up holding certificate of eligible business. However, such start-up is allowed to defer withholding tax when option is exercised and shares are allotted to Mr. X. It is deducted in required manner after expiry of certain timelines and/ or happening of certain events.

(d) Income tax would be withheld when option is granted. Such withholding tax would be deducted at the rates in force at time option is granted to Mr. X.

4. The start-up is planning merger with another start-up engaged in similar activities. Which of the following statements is in line with provisions of law regarding proposed merger of these start-ups?

(a) It requires filing of proposed scheme with NCLT and final order in respect of merger is made by NCLT after following a detailed procedure.

(b) It involves giving notice of proposed scheme to Registrar and Official Liquidators and approval of scheme by both the companies. After approval of scheme by creditors, the scheme is approved by Registrar of Companies.

(c) It involves giving notice of proposed scheme to Registrar and Official Liquidators and approval of scheme by both the companies. After approval of scheme by creditors, the scheme is filed with Regional Director, Registrar and Official Liquidators. The scheme is finally registered by Regional Director.

(d) It requires filing of proposed scheme with NCLT and final order in respect of merger is made by NCLT after following a fast-track procedure.

5. Which of the following is not a factor to be considered for valuing a start-up like GrowFine?

(a) Past performance indicators

(b) Educational background of founders

(c) Uniqueness of product launched by start-up

(d) Traction

II. Descriptive Questions

6. GrowFine has issued equity shares to individuals having face value of ₹10/-per share at a price of ₹ 50/-per share. What are income tax implications for the same for GrowFine? What is such tax commonly and popularly known as? Under which circumstances can GrowFine claim exemption from such a tax?

7. Start-up GrowFine is also planning to approach other investors to fund its business requirements. What specific points shall be considered while carrying out due diligence of such start-up for picking up an equity interest by a prospective investor?

ANSWERS TO THE CASE STUDY 50

I. Answers to the Multiple Choice Questions

1. (c) Funding by angel investors

Reason: Angel investors typically use their own money. Often, they are among an entrepreneur's family and friends. They generally invest in small-start-ups and are attached to the idea of the business floated by start-up. However, venture capitalists take care of pooled money from other investors and place them in a strategically managed fund. Bootstrapping is an attempt to build the

company from personal finances or from operating revenues of the company. Factoring is a method of bootstrapping.

2. (b) Company is eligible to deduction @ 100% of its profits from eligible business for any 3 consecutive assessment years out of 10 years beginning from the year in which start-up is incorporated. Further, certificate of eligible business in this regard is provided by Inter-Ministerial Board for Certification.

Reason: Under section 80-IAC (1) of Income tax act, 1961, where the gross total income of an assessee, being an eligible start- up, includes any profits and gains derived from eligible business, there shall, in accordance with and subject to the provisions of this section, be allowed, in computing the total income of the assessee, a deduction of an amount equal to one hundred per cent of the profits and gains derived from such business for three consecutive assessment years.

The deduction may at the option of the assessee, be claimed by him for any three consecutive assessment years out of ten years beginning from the year in which the eligible start-up is incorporated.

Further, explanation to section 80-IAC also defines eligible start-up which fulfils the following conditions namely: -

(a) it is incorporated on or after the 1st day of April, 2016 but before the 1st day of April, 2024

(b) the total turnover of its business does not exceed one hundred crore rupees in the previous year relevant to the assessment year for which deduction under sub-section (1) is claimed and

(c) it holds a certificate of eligible business from the Inter-Ministerial Board of Certification as notified in the Official Gazette by the Central Government

3. (c) The company is an eligible start-up holding certificate of eligible business. However, such start-up is allowed to defer withholding tax when option is exercised and shares are allotted to Mr. X. It is deducted in required manner after expiry of certain timelines and/ or happening of certain events

Reason: Under section 192(1C), a person, being an eligible start-up referred to in section 80-IAC, responsible for paying any income to the assessee being perquisite of the nature specified in sub clause (*vi*) of sub-section (2) of section

17 in any previous year relevant to the assessment year, shall deduct or pay, as the case may be, tax on such income within fourteen days—

(*i*) after the expiry of forty-eight months from the end of the relevant assessment year or

(*ii*) from the date of the sale of such specified security or sweat equity share by the assessee or

(*iii*) from the date of the assessee ceasing to be the employee of the person

whichever is the earliest, on the basis of rates in force for the financial year in which the said specified security or sweat equity share is allotted or transferred.

Therefore, section 192(IC) provides for deferment of withholding tax in case of eligible start-ups.

4. **(c)** It involves giving notice of proposed scheme to Registrar and Official Liquidators and approval of scheme by both the companies. After approval of scheme by creditors, the scheme is filed with Regional Director, Registrar and Official Liquidators. The scheme is finally registered by Regional Director.

Reason: In case of merger between small companies/ start-ups, fast track procedure for merger has been prescribed under section 233 of Companies Act, 2013. It does not require filing of application with NCLT. The notices are to be given to registrar, official liquidator and Central Govt (powers delegated to Regional Director). After considering objections of registrar and official liquidator, the scheme is finally registered by Regional Director.

5. **(a)** Past performance indicators

Reason: In valuation of a start-up like GrowFine, there is no historical data on basis of which future projections can be drawn. Valuation of a start-up entirely rests on its future growth potential. The assessments of future growth are dependent upon competence and drive of persons running the business.

II. Answers to the Descriptive Questions

6. Under clause (viib) of Sub-section 2 of Section 56 of Income-tax Act, 1961, where a company, not being a company in which the public are substantially interested, receives, in any previous year, from any person, any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for

such shares as exceeds the fair market value of the shares is chargeable to income tax under head ***"Income from other sources".*** Amount received by company which is in excess of fair market value of shares shall be taxable under the head "Income from Other Sources." This tax is commonly and popularly called as ***"Angel tax".***

However, this clause shall not apply where the consideration for issue of shares is received—

(*i*) by a venture capital undertaking from a venture capital company or a venture capital fund or a specified fund; or

(*ii*) by a company from a class or classes of persons as may be notified by the Central Government in this behalf.

Accordingly, the Central Government has, vide Notification No. 30/2023 dated 24.5.23 notified that the provisions of section 56(2)(viib) of Income-tax Act shall not apply to consideration received by a company for issue of shares that exceeds the face value of such shares, if the said consideration has been received from any person, by a company which fulfils the following conditions specified in para 4 of notification number GSR 127(E) dated 19.2.2019 issued by Ministry of Commerce and Industry in the Department for Promotion of Industry and Internal Trade (DPIIT).

(i) it has been recognised by DPIIT under this notification or as per any earlier notification on the subject

(ii) Aggregate amount of paid- up share capital and share premium of the startup after issue or proposed issue of share, if any, does not exceed, twenty five crore rupees.

(iii) It has not invested in any of the following assets, —

  (a) Building or land appurtenant thereto, being a residential house, other than that used by the Startup for the purposes of renting or held by it as stock-in-trade, in the ordinary course of business

  (b) land or building, or both, not being a residential house, other than that occupied by the Startup for its business or used by it for purposes of renting or held by it as stock-in trade, in the ordinary course of business

  (c) loans and advances, other than loans or advances extended in the ordinary course of business by the Startup where the lending of money is substantial part of its business

(d) capital contribution made to any other entity

(e) shares and securities

(f) a motor vehicle, aircraft, yacht or any other mode of transport, the actual cost of which exceeds ten lakh rupees, other than that held by the Startup for the purpose of plying, hiring, leasing or as stock-in-trade, in the ordinary course of business

(g) jewellery other than that held by the Startup as stock-in-trade in the ordinary course of business

(h) any other asset, whether in the nature of capital asset or otherwise, of the nature specified in section 56(2)(vii)(d) (iv) to (ix) of the Act.

It has been further provided that the startup should not invest in any of the above assets for the period of seven years from the end of the latest financial year in which shares are issued at premium.

A start-up fulfilling above conditions has to file a form with DIPP which is forwarded by it to CBDT. By fulfilling above conditions and taking advantage of above notification, start-up can claim exemption from paying angel tax.

7. A prospective investor shall carry out due diligence before picking up equity interest in a start-up. Background of the promoters and credentials would be looked into. It is necessary to verify start-up's claims regarding future growth and numbers. The prospective investor should be convinced about business model of start-up and type of service provided by it. The start-up should be differentiated to meet specific customer needs or to solve a unique customer problem. Besides, start-up should show potential to scale up in near future in accordance with a suitable business plan.

The prospective investor would also look for market size and likely obtainable market share and macroeconomic drivers for the market. The extent of competition in the market in this segment also needs to be looked at. Nonetheless, investor would also be looking for exit avenues. The investor would also be taking into account the fact whether a start-up is showcasing potential future acquirers or alliance partners. It is a valuable parameter for the investor. Subsequent rounds of fundings and acquisitions all are examples of exit options.