Financial Reporting

25 Marks

Question 1:

Assumption: It is assumed that current carrying cost of the CGU block of asset as per Accounting and Tax Records are after charging depreciation of the current year. The assumption has been taken on the basis that impairment loss is calculated on carrying value after charging depreciation of the year.

In the absence of specific instructions, deferred tax workings of current year have been shown as below:

Statement showing Deferred Tax workings for the current year

	₹ *in lakhs*
Depreciation as per Accounting books for the current year $\frac{999}{(1-.1391)}\times.1391$	161.41
Depreciation as per Income Tax Records for the current year $\frac{777}{(1-.15)}\times.15$	137.12
Timing difference	24.29
Tax effect of the above timing difference at 33%* (deferred tax asset) (A)	8.02
Impairment Loss recognised in the profit and loss account (999- 555)	444
Impairment Loss allowed for tax purposes	Nil
Timing difference	444
Tax effect of the above timing difference at 33% (deferred tax asset) (B)	146.52
Total deferred tax asset (A+B)	154.54

Note:

1. Deferred tax asset should be recognised and carried forward only to the extent that there is a reasonable certainty that sufficient future taxable income will be available against which such deferred tax asset can be realised. The Approving Authority of Acute Ltd. have issued signed statement confirming virtual certainty of taxable incomes in the foreseeable future. Therefore, the company can recognize deferred tax asset during the current year.

2. The deferred tax asset calculated on account of difference of depreciation as per accounting and tax records is actually a reversal of deferred tax liability created in the previous years.

Accounting Standard 23

Question 2:

As per para 29 of AS 25 'Interim Financial Reporting', 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.

		₹
Estimated Annual Income	(A)	10,00,000
Tax expense:		
30% on ₹ 5,00,000		1,50,000
40% on remaining ₹ 5,00,000		2,00,000
	(B)	3,50,000

Weighted average annual income tax rate = $\frac{B}{A} = \frac{3,50,000}{10,00,000} = 35\%$

Tax expense to be recognised in each of the quarterly reports	₹
Quarter I - ₹ 75,000 x 35%	26,250
Quarter II - ₹ 2,50,000 x 35%	87,500
Quarter III - ₹ 3,75,000 x 35%	1,31,250
Quarter IV - ₹ 3,00,000 x 35%	1,05,000
₹ 10,00,000	3,50,000

Question 3:

Statement Showing Impairment Loss

		(₹ in crores)
Carrying amount of the machine as on 1st April 2010		7.00
Depreciation for 4 years i.e. 2010-2011 to 2013-2014 $\left[\frac{7\text{crores}}{7\text{years}} \times 4\text{years}\right]$		(4.00)
Carrying amount as on 31.03.2014		3.00
Add: Upward Revaluation (credited to Revaluation Reserve account)		2.10
Carrying amount of the machine as on 1st April 2014 (revalued)		5.10
Less: Depreciation for 2 years i.e. 2014-2015 & 2015-2016 $\left[\frac{5.10\text{ crores}}{3\text{ years}} \times 2\text{ years}\right]$		(3.40)
Carrying amount as on 31.03.2016		1.70
Less: Recoverable amount		(0.79)
Impairment loss		0.91
Less: Balance in revaluation reserve as on 31.03.2016:		
Balance in revaluation reserve as on 31.03.2014	2.10	
Less: Enhanced depreciation met from revaluation reserve 2014-2015 & 2015-2016 =[(1.70 – 1.00) x 2 years]	(1.40)	
Impairment loss set off against revaluation reserve balance as per para 58 of AS 28 "Impairment of Assets"		(0.70)
Impairment Loss to be debited to profit and loss account		0.21

Question 4:

(a) Property, Plant and Equipment

(i) ***Fixed Assets retired from Active Use and Held for Sale:*** Ind AS 16 does not deal with the assets 'held for sale' because the treatment of such assets is covered in Ind AS 105, Non-current Assets Held for Sale and Discontinued Operations. Existing AS 10 deals with accounting for items of fixed assets retired from active use and held for sale.

(ii) ***Stripping Costs in the Production Phase of a Surface Mine:*** Ind AS 16 provides guidance on measuring 'Stripping Costs in the Production Phase of a Surface Mine'. Existing AS does not contain this guidance.

(b) Changes in Accounting Policy and Prior period items

(i) ***Objective***: Objective of existing AS 5 is to prescribe the classification and disclosure of certain items in the statement of profit and loss for uniform preparation and presentation of financial statements. Objective of Ind AS 8 is to prescribe the criteria for selecting and changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and corrections of errors. Ind AS 8 intends to enhance the relevance and reliability of an entity's financial statements and the comparability of those financial statements over time and with the financial statements of other entities.

(ii) ***Extraordinary Items***: Keeping in view that Ind AS 1, '*Presentation of Financial Statements*', prohibits the presentation of any items of income or expense as extraordinary items, Ind AS 8 does not deal with the same.

(iii) ***Definition of Accounting Policies***: Existing AS 5 restricts the definition of accounting policies to specific accounting principles and the methods of applying those principles while Ind AS 8 broadens the definition to include bases, conventions, rules and practices (in addition to principles) applied by an entity in the preparation and presentation of financial statements.

(iv) ***Change in Accounting Policies***: In addition to the situations allowed under Ind AS 8 for changing an accounting policy, existing AS 5 allows change in accounting policy if required by statute.

(v) ***Accounting for Changes in Accounting Policies:*** Ind AS 8 specifically states that an entity shall select and apply its accounting policies consistently for similar transactions, other events and conditions, unless an Ind AS specifically requires or permits categorisation of items for which different policies may be appropriate. Neither existing AS 5 nor any other existing Standard specifically requires accounting policies to be consistent for similar transactions, other events and conditions.

(vi) ***Exceptions in Retrospective Accounting of Changes in Accounting Policies:*** Ind AS 8 requires that changes in accounting policies should be accounted for with retrospective effect subject to limited exceptions viz., where it is impracticable to determine the period specific effects or the cumulative effect of applying a new accounting policy. On the other hand, existing AS 5 does not specify how change in accounting policy should be accounted for.

(vii) ***Prior Period Items***: Existing AS 5 defines prior period items as incomes or expenses which arise in the current period as a result of errors or omissions in the preparation of financial statements of one or more prior periods. Ind AS 8 uses the term 'errors' and relates it to errors or omissions arising from a failure to use or misuse of reliable information (in addition to mathematical mistakes, mistakes in application of accounting policies etc.) that was available when the financial statements of the prior periods were approved for issuance and could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements. Ind AS 8 specifically states that errors include frauds, which is not covered in existing AS 5.

(viii) ***Rectification of Material Prior Period Errors:*** Ind AS 8 requires rectification of material prior period errors with retrospective effect subject to limited exceptions viz., where it is impracticable to determine the period specific effects or the cumulative effect of applying a new accounting policy. On the other hand, existing AS 5 requires the rectification of prior period items with prospective effect.

(c) Inventories

(i) *Subsequent Recognition:* Ind AS 2 deals with the subsequent recognition of cost/carrying amount of inventories as an expense, whereas the existing AS 2 does not provide the same.

(ii) *Inventory of Service Provider:* Ind AS 2 provides explanation with regard to inventories of service providers whereas the existing AS 2 does not contain such an explanation.

(iii) *Machinery Spares:* The existing AS 2 explains that inventories do not include spare parts, servicing equipment and standby equipment which meet the definition of property, plant and equipment as per AS 10, Property, Plant and Equipment. Such items are accounted for in accordance with Accounting Standard (AS) 10, Property, Plant and Equipment. Ind AS 2 does not contain specific explanation in respect of such spares as this aspect is covered under Ind AS 16.

(iv) *Inventory held by Commodity Broker-traders:* Ind AS 2 does not apply to measurement of inventories held by commodity broker-traders, who measure their inventories at fair value less costs to sell. However, this aspect is not there in the existing AS 2.

(v) *Definition of Fair Value and Distinction Between NRV and Fair Value:* Ind AS 2 defines fair value and provides an explanation in respect of distinction between 'net realisable value' and 'fair value'. The existing AS 2 does not contain the definition of fair value and such explanation.

(vi) *Subsequent Assessment of NRV:* Ind AS 2 provides detailed guidance in case of subsequent assessment of net realisable value. It also deals with the reversal of the write-down of inventories to net realisable value to the extent of the amount of original write-down, and the recognition and disclosure thereof in the financial statements. The existing AS 2 does not deal with such reversal.

(vii) *Inventories Acquired on Deferred Settlement Terms:* An entity may purchase inventories on deferred settlement terms. When the arrangement effectively contains a financing element, that element, for example a difference between the purchase price for normal credit terms and the amount paid, is recognised as interest expense over the period of the financing.

(viii) *Exclusion from its Scope but Guidance given:* Ind AS 2 excludes from its scope only the measurement of inventories held by producers of agricultural and forest products, agricultural produce after harvest, and minerals and mineral products though it provides guidance on measurement of such inventories. However, the existing AS 2 excludes from its scope such types of inventories.

(ix) *Cost Formulae:* The existing AS 2 specifically provides that the formula used in determining the cost of an item of inventory should reflect the fairest possible approximation to the cost incurred in bringing the items of inventory to their present

location and condition whereas Ind AS 2 does not specifically state so and requires the use of consistent cost formulas for all inventories having a similar nature and use to the entity.

Question 5:

As per IFRS: IFRS 3 requires bargain purchase gain arising on business combination to be recognised in profit or loss as income.

Carve out: Ind AS 103 requires the bargain purchase gain to be recognised in other comprehensive income and accumulated in equity as capital reserve, unless there is no clear evidence for the underlying reason for classification of the business combination as a bargain purchase, in which case, it shall be recognised directly in equity as capital reserve. A similar carve-out is made in Ind AS 28, Investments in Associates and Joint Ventures.

Reasons: At present, since bargain purchase gain occurs at the time of acquiring a business, these are considered as capital reserve. Recognition of such gains in profit or loss would result into recognition of unrealised gains, which may get distributed in the form of dividends. Moreover, such a treatment may lead to structuring through acquisitions, which may not be in the interest of the stakeholders of the company.

Strategic Financial management

25 Marks

Question 1:

Calculation of Covariance

Year	R_1	Deviation $(R_1 - \overline{R_1})$	Deviation $(R_1 - \overline{R_1})^2$	R_2	Deviation $(R_2 - \overline{R_2})$	Deviation $(R_2 - \overline{R_2})^2$	Product of deviations
1	12	-2.8	7.84	20	-1	1	2.8
2	8	-6.8	46.24	22	1	1	-6.8
3	7	-7.8	60.84	24	3	9	-23.4
4	14	-0.8	0.64	18	-3	9	2.4
5	16	1.2	1.44	15	-6	36	-7.2
6	15	0.2	0.04	20	-1	1	-0.2
7	18	3.2	10.24	24	3	9	9.6
8	20	5.2	27.04	25	4	16	20.8
9	16	1.2	1.44	22	1	1	1.2
10	22	7.2	51.84	20	-1	1	-7.2
$\overline{R_1} = \frac{148}{10} = 14.8$			$\Sigma = 207.60$		$\overline{R_2} = \frac{210}{10} = 21$	$\Sigma = 84.00$	

$$\text{Covariance} = \frac{\sum_{i=1}^{N} [R_1 - \overline{R_1}][R_2 - \overline{R_2}]}{N} = -8/10 = -0.8$$

Standard Deviation of Security 1

$$\sigma_1 = \sqrt{\frac{(R_1 - \overline{R_1})^2}{N}}$$

$$\sigma_1 = \sqrt{\frac{207.60}{10}} = \sqrt{20.76}$$

$$\sigma_1 = 4.56$$

Standard Deviation of Security 2

$$\sigma_2 = \sqrt{\frac{(R_2 - \overline{R_2})^2}{N}}$$

$$\sigma_2 = \sqrt{\frac{84}{10}} = \sqrt{8.40}$$

$$\sigma_2 = 2.90$$

Alternatively, Standard Deviation of securities can also be calculated as follows:

Calculation of Standard Deviation

Year	R_1	R_1^2	R_2	R_2^2
1	12	144	20	400
2	8	64	22	484
3	7	49	24	576

4	14	196	18	324
5	16	256	15	225
6	15	225	20	400
7	18	324	24	576
8	20	400	25	625
9	16	256	22	484
10	22	484	20	400
	148	2398	210	4494

Standard deviation of security 1:

$$\sigma_1 = \sqrt{\frac{N\sum R_1^2 - (\sum R_1)^2}{N^2}}$$

$$= \sqrt{\frac{(10\times 2398) - (148)^2}{10\times 10}} = \sqrt{\frac{23980 - 21904}{100}}$$

$$= \sqrt{20.76} = 4.56$$

Standard deviation of security 2:

$$\sigma_2 = \sqrt{\frac{N\sum R_2^2 - (\sum R_2)^2}{N^2}}$$

$$= \sqrt{\frac{(10\times 4494) - (210)^2}{10\times 10}} = \sqrt{\frac{44940 - 44100}{100}}$$

$$= \sqrt{\frac{840}{100}} = \sqrt{8.4} = 2.90$$

Correlation Coefficient

$$r_{12} = \frac{Cov}{\sigma_1 \sigma_2} = \frac{-0.8}{4.56\times 2.90} = \frac{-0.8}{13.22} = -0.0605$$

Question 2:

Securities need to be ranked on the basis of excess return to beta ratio from highest to the lowest.

Security	R_i	β_i	$R_i - R_f$	$\frac{R_i - R_f}{\beta_i}$
A	15	1.5	8	5.33
B	12	2	5	2.5
C	10	2.5	3	1.2
D	9	1	2	2
E	8	1.2	1	0.83
F	14	1.5	7	4.67

Ranked Table:

Security	$R_i - R_f$	β_i	σ^2_{ei}	$\frac{(R_i - R_f) \times \beta}{\sigma^2_{ei}}$	$\sum_{c=i}^{N} \frac{(R_i - R_f) \times \beta}{\sigma^2_{ei}}$	$\frac{\beta_i^2}{\sigma^2_{ei}}$	$\sum_{c=i}^{N} \frac{\beta_i^2}{\sigma^2_{ei}}$	C_i
A	8	1.5	40	0.30	0.30	0.056	0.056	1.923
F	7	1.5	30	0.35	0.65	0.075	0.131	2.814
B	5	2	20	0.50	1.15	0.20	0.331	2.668
D	2	1	10	0.20	1.35	0.10	0.431	2.542
C	3	2.5	30	0.25	1.60	0.208	0.639	2.165
E	1	1.2	20	0.06	1.66	0.072	0.711	2.047

CA = 10 x 0.30 / [1 + (10 x 0.056)] = 1.923

CF = 10 x 0.65 / [1 + (10 x 0.131)] = 2.814

CB = 10 x 1.15 / [1 + (10 x 0.331)] = 2.668

CD = 10 x 1.35 / [1 + (10 x 0.431)] = 2.542

CC = 10 x 1.60 / [1 + (10 x 0.639)] = 2.165

CE = 10 x 1.66 / [1 + (10 x 0.7111)] = 2.047

Cut off point is 2.814

$$Z_i = \frac{\beta_i}{\sigma^2_{ei}} \left[\frac{(R_i - R_f)}{\beta_i} - C \right]$$

$$Z_A = \frac{1.5}{40}(5.33 - 2.814) = 0.09435$$

$$Z_F = \frac{1.5}{30}(4.67 - 2.814) = 0.0928$$

$$X_A = 0.09435 / [0.09435 + 0.0928] = 50.41\%$$

$$X_F = 0.0928 / [0.09435 + 0.0928] = 49.59\%$$

Funds to be invested in security A & F are 50.41% and 49.59% respectively.

Question 3:

(i)

Period	R_X	R_M	$R_X - \bar{R}_X$	$R_M - \bar{R}_M$	$(R_X - \bar{R}_X)(R_M - \bar{R}_M)$	$(R_M - \bar{R}_M)^2$
1	20	22	5	10	50	100
2	22	20	7	8	56	64
3	25	18	10	6	60	36
4	21	16	6	4	24	16
5	18	20	3	8	24	64
6	-5	8	-20	-4	80	16

7	17	-6	2	-18	-36	324
8	19	5	4	-7	-28	49
9	-7	6	-22	-6	132	36
10	20	11	5	-1	-5	1
	150	120			357	706
	ΣR_X	ΣR_M			$\sum (R_X - \bar{R}_X)(R_M - \bar{R}_M)$	$\sum (R_M - \bar{R}_M)^2$

$\bar{R}_X = 15 \quad \bar{R}_M = 12$

$$\sigma^2{}_M = \frac{\sum\left(R_M - \bar{R}_M\right)^2}{n} = \frac{706}{10} = 70.60$$

$$Cov_{XM} = \frac{\sum\left(R_X - \bar{R}_X\right)\left(R_M - \bar{R}_M\right)}{n} = \frac{357}{10} = 35.70$$

$$Beta_x = \frac{Cov_{XM}}{\sigma^2_M} = \frac{35.70}{70.60} = 0.505$$

Alternative Solution

Period	X	Y	Y^2	XY
1	20	22	484	440
2	22	20	400	440
3	25	18	324	450
4	21	16	256	336
5	18	20	400	360
6	-5	8	64	-40
7	17	-6	36	-102
8	19	5	25	95
9	-7	6	36	-42
10	20	11	121	220
	150	120	2146	2157
	$\bar{X} = 15$	$\bar{Y} = 12$		

$$= \frac{\Sigma XY - n\bar{X}\bar{Y}}{\Sigma X^2 - n(\bar{X})^2}$$

$$= \frac{2157 - 10 \times 15 \times 12}{2146 - 10 \times 12 \times 12} = \frac{357}{706} = 0.506$$

(ii) $\bar{R}_X = 15 \ \bar{R}_M = 12$

$y = \alpha + \beta x$

$15 = \alpha + 0.505 \times 12$

Alpha (α) $= 15 - (0.505 \times 12) = 8.94\%$

Characteristic line for security $X = \alpha + \beta \times R_M$

Where, R_M = Expected return on Market Index

$\therefore$ Characteristic line for security $X = 8.94 + 0.505\ R_M$

Question 4:

(i) Gordon's Formula

$$P_0 = \frac{E(1-b)}{K-br}$$

P_0 = Present value of Market price per share

E = Earnings per share

K = Cost of Capital

b = Retention Ratio (%)

r = IRR

br = Growth Rate

$$P_0 = \frac{₹12(1-0.40)}{0.18-(0.40\times0.22)}$$

$$= \frac{₹7.20}{0.18-0.088} = \frac{₹7.20}{0.092}$$

$$= ₹78.26$$

(ii) Walter's Formula

$$V_c = \frac{D+\frac{R_a}{R_c}(E-D)}{R_c}$$

V_c = Market Price

D = Dividend per share

R_a = IRR

R_c = Cost of Capital

E = Earnings per share

$$= \frac{₹3+\frac{0.22}{0.18}(₹12-₹3)}{0.18}$$

$$= \frac{₹3+₹11}{0.18}$$

$$= ₹77.77$$

Alternative Solution- As per the data provided in the question the retention ratio comes out to be 75% (as computed below) though mentioned in the question as 40%

(i) Gordon's Formula

$$\text{Retention Ratio} = \frac{\text{EPS-Dividend Per Share}}{\text{EPS}} = \frac{₹12-₹3}{₹12} = 0.75 \text{ i.e. } 75\%$$

With the retention ratio of 75% market price per share using the Gordons Formula shall be as follows

$$P_0 = \frac{E(1-b)}{K-br}$$

P_0 = Present value of Market price per share

E = Earnings per share

K = Cost of Capital

b = Retention Ratio (%)

r = IRR

br = Growth Rate

$$P_0 = \frac{12(1-0.75)}{0.18-(0.75\times 0.22)}$$

$$= \frac{3}{0.18-0.165} = ₹\ 200$$

(ii) Walter's Formula

$$V_c = \frac{D+\frac{R_a}{R_c}(E-D)}{R_c}$$

V_c = Market Price

D = Dividend per share

R_a = IRR

R_c = Cost of Capital

E = Earnings per share

$$= \frac{₹\,3+\frac{0.22}{0.18}(₹\,12-₹\,3)}{0.18}$$

$$= \frac{₹\,3+₹11}{0.18} = ₹\ 77.77$$

<u>Corporate And Allied Law</u>

<u>25 Marks</u>

Question 1:

Problem as asked in the question is based on the provisions of the Companies Act, 2013 as contained under section 161 (1) according to which :

(A) The Articles of a company may confer upon its Board of Directors the power to appoint any person as an additional director at any time.

(B) A person, who fails to get appointed as a director in a general meeting of the company cannot be appointed as an additional director in the same company.

(C). Additional director shall hold office up to the date of the next AGM or the last date on which the AGM should have been held, whichever is earlier.

In the given case, the answers to sub-questions are:

(i) The appointment of Mr. K. as additional director by the Board of Directors is not valid because before appointing him as an additional director, the proposal to appoint Mr. K. as a director on the Company's Board was rejected by the members at the company's Annual General Meeting.

(ii) The power to appoint additional directors vests with the Board of Directors and not with the members of the company. The only condition is that the Board must be conferred such power by the articles of the company. Therefore, in the present case, the company's Annual General Meeting cannot appoint Mr. K. as the additional director when the proposal to appoint comes before the meeting for the first time because the company's Articles empower the Board of Directors to appoint additional director.

(iii) In case the AGM of the company is not held within the stipulated time, Mr. K. cannot continue as additional director, since he can hold the office of directorship only 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. Such an additional director shall vacate his office latest on the date on which the annual general meeting ought to have been held under Section 96 of the Companies Act, 2013. He cannot continue in the office on the ground that the meeting was not held or could not be called within the time prescribed.

Question 2:

International Technologies Limited, a listed company, being managed by a Managing Director proposes to pay the following managerial remuneration:

(i) Commission at the rate of 5% of the net profits to its Managing Director, Mr. Kamal: Part (i) of the second proviso to section 197(1), provides that except with the approval of the company in general meeting, the remuneration payable to any one managing director; or whole time director or manager shall not exceed 5 % of the net profits of the company and if there is more than one such director then remuneration shall not exceed 10 % of the net profits to all such directors and manager taken together.

In the present case, since the International Technologies Limited is being managed by a Managing Director, the commission at the rate of 5% of the net profit to Mr.

Kamal, the Managing Director is allowed and no approval of company in general meeting is required.

(ii) The directors other than the Managing Director are proposed to be paid monthly remuneration of ₹ 50,000 and also commission at the rate of 1 % of net profits of the company subject to the condition that overall remuneration payable to ordinary directors including monthly remuneration payable to each of them shall not exceed 2 % of the net profits of the company: Part (ii) of the second proviso to section 197(1) provides that except with the approval of the company in general meeting, the remuneration payable to directors who are neither managing directors nor whole time directors shall not exceed-

(A) 1% of the net profits of the company, if there is a managing or whole time director or manager;

(B) 3% of the net profits in any other case.

In the present case, the maximum remuneration allowed for directors other than managing or whole time director is 1% of the net profits of the company because the company is having a managing director also. Hence, if the company wants to fix their remuneration at not more than 2% of the net profits of the company, the approval of the company in general meeting is required.

(iii) The company also proposes to pay suitable additional remuneration to Mr. Bhatt, a director, for professional services rendered as software engineer, whenever such services are utilized:

(1) According to section 197(4), the remuneration payable to the directors of a company, including any managing or whole-time director or manager, shall be determined, in accordance with and subject to the provisions of this section, either

(i) by the articles of the company, or

(ii) by a resolution or,

(iii) if the articles so require, by a special resolution, passed by the company in general meeting, and

(2) the remuneration payable to a director determined aforesaid shall be inclusive of the remuneration payable to him for the services rendered by him in any other capacity.

(3) Any remuneration for services rendered by any such director in other capacity shall not be so included if—

(i) the services rendered are of a professional nature; and

(ii) in the opinion of the Nomination and Remuneration Committee, if the

company is covered under sub-section (1) of section 178, or the Board of Directors in other cases, the director possesses the requisite qualification for the practice of the profession.

Hence, in the present case, the additional remuneration to Mr. Bhatt, a director for professional services rendered as software engineer will not be included in the maximum managerial remuneration and is allowed but opinion of Nomination and Remuneration Committee is to be obtained.

Also, the International Technologies Limited (a listed company) shall disclose in the Board's report, the ratio of the remuneration of each director to the median employee's remuneration and such other details as may be prescribed under the Companies (Appointment and Remuneration of Managerial personnel) Rules, 2014.

Question 3:

According to the Companies Act, 2013, the Central Government under section 210 (1) may order an investigation into the affairs of the company, if it is of the opinion that it is necessary to do so:

(a) on the receipt of a report of the Registrar or Inspector under section 208;

(b) on intimation of a special resolution passed by a company that the affairs of the company ought to be investigated;

(c) in public interest.

According to section 210 (3) of the Companies Act, 2013, the Central Government may appoint one or more persons as inspectors to investigate into the affairs of the company and to report thereon in such manner as the Central Government may direct.

The shareholders' application will not be accepted as under 210 of the Companies Act, 2013, Central Government may order an investigation into affairs of the company on the intimation of a special resolution passed by a company that the affairs of the company ought to be investigated and then may appoint the inspectors. Here, 101 out of total 500 shareholders of the company have made an application to the Central Government to appoint an inspector to carry out investigation but it is not sufficient as the company has not passed the special resolution.

Question 4:

(i) *According to Rule 4 of the Companies (Appointment and Qualification of Directors) Rules, 2014, the following class or classes of companies shall have at least 2 directors as independent directors:*

(1) *the Public Companies having paid up share capital of 10 crore rupees or more; or*

(2) *the Public Companies having turnover of 100 crore rupees or more; or*

(3) *the Public Companies which have, in aggregate, outstanding loans, debentures and deposits, exceeding 50 crore rupees.*

In the present case, XYZ Limited is an unlisted public company having a paid-up capital of ₹ 20 crores as on 31st March, 2015 and a turnover of ₹ 150 crores during the year ended 31st March, 2015. Thus, as per the Companies (Appointment and Qualification of Directors) Rules, 2014, XYZ Limited shall have at least 2 directors as independent directors.

(ii) *According to section 149(4) of the Companies Act, 2013, every listed public company shall have at least one-third of the total number of directors as independent directors.*

In the present case, XYZ Limited is a listed company and the total number of directors is 13. Hence, in this case, XYZ Limited shall have atleast 5 directors (1/3 of 13 is 4.33 rounded as 5) as independent directors.

The explanation to section 149(4) specifies that any fraction contained in such one-third numbers shall be rounded off as one.

As the explanation to rule 4 of the Companies (Appointment and Qualification of Directors) Rules, 2014 specifies that for the purpose of the assessment of the paid up share capital or turnover or outstanding loans, debentures and deposits, as the case may be, their existence on the last date of latest audited financial statements shall be taken into account.

In the present case, it is mentioned that paid up capital of XYZ Limited is ₹ 20 crore on 31st March, 2015 and turnover is ₹ 150 crore during the year ended 31st March, 2015. So, it is assumed that 31st March, 2015 is the last date of latest audited financial statements.

Question 5:

Section 5 deals with combination of enterprises and persons. The amalgamation of enterprises shall be a combination of such enterprises if the enterprise created as a result of the amalgamation, as the case may be, have either in India, the assets of the value of more than ₹ 1,000 crores or turnover more than ₹ 3000 crores.

Vide Notification No. S.O. 480(E), dated 4th March, 2011, the Central governmemt enhanced the value of assets and value of turnover by fifty percent.

However, pursuant to Notification No. S.O. 675 (E) dated March 4, 2016 the value of assets and the value of turnover has been enhanced by the Central Government by 100% for the purposes of Section 5 of the Act.

So, the revised value of assets and turnover is presently more than ₹ 2000 crore and ₹ 6000 Crore.

Hence, in the present case, the proposed amalgamation of Bombay Textiles Limited and Gujarat Textiles Limited will not attract the provisions of the Competition Act, 2002 as they have assets of value of ₹ 1000 crore and turnover of ₹ 3000 crore which are less than specified under the provisions.

[Note: Answer is revised as per the Notification No. S.O. 675 (E) dated March 4, 2016]

Advanced Auditing

25 Marks

Question 1:

Identification of possible sources for Related Parties' information: As per SA 550 on, "Related Parties", the auditor should review information provided by the management of the entity identifying the names of all known related parties. However, it is the management, which is primarily responsible for identification of related parties. The duties of an auditor with regard to reporting of related party transaction as required by Accounting Standard 18 "Related Party Disclosures" is given in SA 550.

(i) SA 550 requires that to identify names of all known related parties, the auditor may inspect records or documents that may provide information about related party relationships and transactions, for example entity income tax returns, information supplied by the entity to regulatory authorities, shareholder registers to identify the entity's principal shareholders, statements of conflicts of interest from management and those charged with governance, records of the entity's investments and those of its pension plans, contracts and agreements with key management or those charged with governance, significant contracts and agreements not in the entity's ordinary course of business, specific invoices and correspondence from the entity's professional advisors, life insurance policies acquired by the entity, significant contracts re-negotiated by the entity during the period, internal auditors' reports, documents associated with the entity's filings with a securities regulator (e.g., prospectuses).

(ii) Some arrangements that may indicate the existence of previously unidentified or undisclosed related party relationships or transactions as an arrangement involves a formal or informal agreement between the entity and one or more other parties for such purposes as the establishment of a business relationship through appropriate vehicles or structures, the conduct of certain types of transactions under specific terms and conditions or the provision of designated services or financial support.

Examples of arrangements that may indicate the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor include participation in unincorporated partnerships with other parties, agreements for the provision of services to certain parties under terms and conditions that are outside the entity's normal course of business, guarantees and guarantor relationships etc.

(iii) Obtaining further information on significant transactions outside the entity's normal course of business enables the auditor to evaluate whether fraud risk factors, if any, are present and, where the applicable financial reporting framework establishes related party requirements, to identify the risks of material misstatement. In addition, the auditor needs to be alert for transactions which appear unusual in the circumstances and which may indicate the existence of previously unidentified related parties. Examples of transactions outside the entity's normal course of business may include complex equity transactions, such as corporate restructurings or acquisitions, transactions with offshore entities in jurisdictions with weak corporate laws, the leasing of premises or the rendering of management services by the entity to another party if no consideration is exchanged, sales transactions with unusually large discounts or returns, transactions with circular arrangements, for example, sales with a commitment to repurchase, transactions under contracts whose terms are changed before expiry etc.

(iv) Finally, the auditor should also obtain a written representation from the management concerning the completeness of information provided regarding the identification of related parties.

Question 2:

(b) As per **SA 510 "Initial Audit Engagements—Opening Balances"**, in conducting an initial audit engagement, the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether:

(i) Opening balances contain misstatements that materially affect the current period's financial statements; and

(ii) Appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

Being new assignment audit evidence regarding opening balances can be obtained by perusing the copies of the audited financial statements.

For current assets and liabilities some audit evidence can ordinarily be obtained as part of audit procedures during the current period. For example, the collection/payment of opening balances of receivables and payables will provide audit evidence as to their existence, rights and obligations, completeness and valuation at the beginning of the period.

In respect of other assets and liabilities such as fixed assets, investments long term debt, the auditor will examine the records relating to opening balances. The auditor may also be able to get confirmation from third parties (e.g., balances of long term loan obtained from banks).

Question 3:

Evaluating Going Concern Assumption: SA 570 "Going Concern", requires that while planning a performing audit procedure and in evaluating the results thereof, the auditor should consider the appropriateness of the going concern assumption underlying the preparation of the financial statements. In assessing such a risk, the auditor should examine the following indications-

Financial Indications.

- ***Net liability or net current liability position.***
- ***Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment; or excessive reliance on short-term borrowings to finance long-term assets.***
- ***Indications of withdrawal of financial support by creditors.***
- ***Negative operating cash flows indicated by historical or prospective financial statements.***
- ***Adverse key financial ratios.***

- ***Substantial operating losses or significant deterioration in the value of assets used to generate cash flows.***
- ***Arrears or discontinuance of dividends.***
- ***Inability to pay creditors on due dates.***
- ***Inability to comply with the terms of loan agreements.***
- ***Change from credit to cash-on-delivery transactions with suppliers.***
- ***Inability to obtain financing for essential new product development or other essential investments.***

Operating Indications.

- ***Management intentions to liquidate the entity or to cease operations.***
- ***Loss of key management without replacement.***
- ***Loss of a major market, key customer(s), franchise, license, or principal supplier(s).***
- ***Labor difficulties.***
- ***Shortages of important supplies.***

- ***Emergence of a highly successful competitor.***

Other Indications.

- ***Non-compliance with capital or other statutory or regulatory requirements, such as solvency or liquidity requirements for financial institutions.***
- ***Pending legal or regulatory proceedings against the entity that may, if successful, result in claims that the entity is unlikely to be able to satisfy.***
- ***Changes in law or regulation or government policy expected to adversely affect the entity.***
- ***Uninsured or underinsured catastrophes when they occur.***

The significance of such events or conditions often can be mitigated by other factors. For example, the effect of an entity being unable to make its normal debt repayments may be counter-balanced by management's plans to maintain adequate cash flows by alternative means, such as by disposing of assets, rescheduling loan repayments, or obtaining additional capital. Similarly, the loss of a principal supplier may be mitigated by the availability of a suitable alternative source of supply.

Question 4:

Due Diligence Exercise in case of Overvalued Assets: Due diligence is an all pervasive exercise to review all important aspects like financial, legal, commercial, etc. before taking any final decision in the matter. As far as any overvalued assets are concerned, this shall form part of such a review. Normally, overvalued assets are not apparent from books of accounts and financial statements. Review of financial statements does involve examination from the view point of extraordinary items, analysis of significant deviations, etc. However, in order to reduce the risk of over valuation of assets, the auditor should pay his attention to the following areas:

Overvalued assets: The auditor shall have to specifically examine the following areas -

(i) Uncollected/uncollectable receivables.

(ii) Obsolete, slow non-moving inventories or inventories valued above NRV; huge inventories of packing materials etc. with the name of company.

(iii) Underused or obsolete Plant and Machinery and their spares; asset values which have been impaired due to sudden fall in market value etc.

(iv) Assets carried at much more than current market value due to capitalization of expenditure/foreign exchange fluctuation, or capitalization of expenditure mainly in the nature of revenue.

(v) Litigated assets and property.

(vi) Investments carried at cost though realizable value is much lower.

(vii) Investments carrying a very low rate of income / return.

(viii) Infructuous project expenditure/deferred revenue expenditure etc.

(ix) Group Company balances under reconciliation etc.

(x) Intangibles of no value.

Question 5:

Areas in which Due Diligence can take place -

(i) Commercial/operational due diligence: It is generally performed by the concerned acquire enterprise involving an evaluation from commercial, strategic and operational perspectives. For example, whether proposed merger would create operational synergies.

(ii) Financial Due Diligence: It involves analysis of the books of accounts and other information pertaining to financial matters of the entity. It should be performed after completion of commercial due diligence.

(iii) Tax Due diligence: It is a separate due diligence exercise but since it is an integral component of the financial status of a company, it is generally included in the financial due diligence. The accountant has to look at the tax affect of the merger or acquisition.

(iv) Information systems due diligence: It pertains to all computer systems and related matter of the entity.

(v) Legal due diligence: This may be required where legal aspects of functioning of the entity are reviewed. For example, the legal aspects of property owned by the entity or compliance with various statutory requirements under various laws.

(vi) Environmental due diligence: It is carried out in order to study the entity's environment, its flexibility and adaptiveness to the acquirer entity.

(vii) Personnel due diligence: It is carried out to ascertain that the entity's personnel policies are in line or can be changed to suit the requirements of the restructuring.

Question 6:

Following are some provisions of the Sarbanes-Oxley Act of 2002, which, if enacted in India may be fruitful is respect of Indian corporate:

(i) More independence be given to Audit Committee and auditor.

(ii) Ban on personal loan to Directors / Executive Officers of a Company.

(iii) Strict reporting by an auditor on insider trading.

(iv) Additional disclosures imposed on financial reporting.

(v) If there is any conflict between company and its auditor, the Audit Committee should be empowered to resolve the same.

(vi) Higher penalties and criminal prosecution on financial frauds.

(vii) To include effectiveness of Internal Control System in the financial reporting.

(viii) More responsibilities must be imposed on managerial personal with higher penalties and prosecutions on the breach.

(ix) Strict action against white collar crime.

(x) Disclosure of the % of shareholdings by Directors, Executive Officers and principal shareholders.

-

Advanced Management Accounting

25 Marks

Question 1:

(1) Statement Showing Variable Cost *per* 200-unit lot

	(₹)	(₹)
Cushion Material:		
- Padding	9.60	
- Vinyl	16.00	
Total Cushion Material	25.60	
Cost Increase by 20%	5.12	
Cost of Cushioned Seat		30.72
Cushion Fabrication Labour (₹30 × 0.5)		15.00
Variable Overhead (W.N.-2) (₹20 × 0.5)		10.00
Variable Cost *per Cushioned Seat*		55.72
Total Variable Cost *per* 200-unit lot (₹55.72 × 200)		11,144

(2) Statement Showing Fixed Overhead & Variable Overhead Rate per Direct Labour Hour

	Variable Amount		Fixed Amount	
	(₹)	(₹)	(₹)	(₹)
	Total	Per DLH	Total	Per DLH
Indirect Material	16,80,000	5.60	---	---
Indirect Labour	15,00,000	5.00	---	---
Supervision	---	---	10,00,000	3.33
Power	7,20,000	2.40	---	---
Heat and Light	---	---	5,60,000	1.87
Miscellaneous Overheads	---	---	8,00,000	2.67
Depreciation	---	---	68,00,000	22.67
Employee Benefits:				
- 20% Direct Labour*	18,00,000	6.00	---	---
- 20% Supervision	---	---	2,00,000	0.66
- 20% Indirect Labour	3,00,000	1.00	---	---
	60,00,000	20.00	93,60,000	31.20

Variable Overhead Rate = ₹60,00,000 ÷ 3,00,000

= ₹20.00 / DLH

Fixed Overhead Rate = ₹93,60,000 ÷ 3,00,000

= ₹31.20 / DLH

* Direct Labour Cost

0.2 (₹ 10,00,000 + DL + ₹ 15,00,000) = ₹23,00,000

0.2 DL = ₹18,00,000

DL = ₹90,00,000

(3) Statement Showing "Loss of Contribution Margin from Outside Sales"

	Stylish Stool (₹)	Normal Stool (₹)
Selling Price	225.00	160.00
Less: Material	58.20	63.04
Less: Labour	45.00 (₹30.00 × 1.5)	24.00 (₹30.00 × 0.8)
Less: Variable Overhead	30.00 (₹20.00 × 1.5)	16.00 (₹20.00 × 0.8)
Contribution Margin *per unit*	91.80	56.96
Units Produced (units)	200	250 (W.N.- 4)
	18,360	14,240

Amount of Contribution Margin Lost as a result of shifting production to the Normal Stool ₹4,120 (₹18,360 – ₹14,240).

(4) Number of Economy Office Stools *that can be produced*

Labour Hours *to make* a 200-unit lot of Stylish Stools (1.50 × 200) 300 Hrs

Less: Labour Hours *to make* a 200-unit lot of Cushioned Seats (0.50 × 200) 100 Hrs

Question 2:

Statement Showing "Allocation of Seats in the Aircraft"

Existing Situation	
For Destination A to B	
Seating Capacity of the Aircraft	260 Passengers
Average Number of Passengers *per flight*	240 Passengers
Proposed Situation	
For Destination D to B	

Seats Booked by Haltgo Ltd.	50 Seats
For Destination A to B	
Seats Available {260 (capacity) – 50 (booked by Haltgo Ltd. for destination D to B)}	210 Seats
Requirement of Regular Passengers {240 (original no. of passengers) – 25 (no. of passengers drop out due to wastage of time)}	215 Seats
Possible Allocation of Seats to Regular Passengers	210 Seats
For Destination A to D	
Seats Available {260 (capacity) – 210 (seats allocated to regular passengers of destination A to B)}	50 Seats
Requirement of Agents (tickets can be sold by Flyway's travel agents)	60 Seats
Possible Allocation to Agents of Flyway Ltd.	50 Seats

Existing Situation

Profit per Flight

	(₹)	**(₹)**
Revenue *per passenger* (Gross Fare)		5,000
Less: Total Variable Cost *per passenger:*		
10% Commission on Fare	500	
Food	300	800
Contribution *per passenger*		4,200
Contribution *per flight* (Contribution for 240 Passengers)		10,08,000
Less: Fixed Costs *per flight*		
Fuel Cost	90,000	
Annual Lease Cost	2,00,000	
Ground Service, Baggage Handling / Checking in	40,000	
Flight Crew Salaries	48,000	3,78,000
Profit *per flight*		6,30,000

Break-even Point

Break-even Number of Passengers[@] $\left(\frac{₹3,78,000}{₹4,200}\right)$	90 Passengers

[@] $\text{Break-even Number of Passengers} = \frac{\text{Total Fixed Cost per Flight}}{\text{Contribution per Passenger}}$

Proposed Situation

Contribution per Passenger (A to D)

	(₹)	(₹)
Revenue *per passenger* (Gross Fare)		3,000
Less: Total Variable Cost *per passenger:*		
10% Commission on Fare	300	
Food[#]	300	600
Contribution *per passenger*		2,400

Statement Showing "Additional Revenue / Expenditure from Haltogo Ltd.'s Offer"

	Additional	
	Cost (₹)	**Revenue (₹)**
Revenue from Destination D to B (50 Seats × ₹2,700)		1,35,000
Contribution from Destination A to D (50 Seats × ₹2,400)		1,20,000
Contribution Lost for Destination A to B (30 Seats* × ₹4,200)	1,26,000	
Snacks (260 Passengers × ₹200)	52,000	
Fuel Cost	45,000	
Airport Landing / Baggage Handling Charges	19,000	
Total	**2,42,000**	**2,55,000**

* *240 Seats (existing) Less 210 Seats (proposed)*

\# *All the passengers booked for destination A to D are also served food free of cost*

Flyway Ltd. will gain ₹13,000 (₹2,55,000 – ₹2,42,000) per flight if it accepts Haltgo's offer.

Decision

Accept Haltgo's offer

Question 3:

Sl. No.	Division (More Advantage)	Reason
(i)	G	G is utilizing only 40% of production capacity by selling to 'External Market' which implies that G might have not been able to recover its full fixed costs. By transferring 20% of its production capacity to division R at full cost, G will be able to recover fixed costs components.
(ii)	G	G will not be loosing any external market demand as it is within its production capacity. By transferring 20% of production capacity to division R at market price, G will earn extra contribution towards the fixed costs and profit.
(iii)	R	Here G is operating at 100% capacity level and external market demand is 80% only i.e. G is not loosing any external market demand. But by transferring 20% of production capacity to R at marginal cost i.e. at variable cost, G may not be able to recover fixed cost part of total cost. On the other hand R will be able to get these units at marginal cost only.
(iv)	G	Though G is loosing its 10% of external market demand but it would be able to earn the same revenue by transferring the goods to division R at market price. Moreover G will be able to utilize 100% of its production capacity.

Question 4:

The main objectives of Uniform Costing are as follows:

(i) **Facilitates Comparison:** To facilitate the comparison of costs and performances of different units in the same industry; it provides objective basis.

(ii) **Eliminates Unhealthy Competition:** To eliminate unhealthy competition among the different units of an industry.

(iii) **Improves Efficiency:** To improve production capacity level and labour efficiency by comparing the production costs of different units with each other.

(iv) **Provides Relevant Data:** To provide relevant cost information/ data to the Government for fixing and regulating prices of the products.

(v) **Ensures Standardisation:** To bring standardisation and uniformity in the operation of participating units.

(vi) **Reduces Cost:** To reduce production, administration, selling and distribution costs, and to exercise control on fixed costs.

Question 5:

The unique characteristic features in performance measurement in service sector are:

(i) Most services are intangible.

(ii) Service outputs vary from day to day.

(iii) The production and consumption of many services are inseparable.

(iv) Services are perishable and cannot be stored.

KSA - SAP EXAM -ISCA

Question 1:

The key functions of the IT Steering Committee would include the following:

- To ensure that long and short-range plans of the IT department are in tune with enterprise goals and objectives;
- To establish size and scope of IT function and sets priorities within the scope;
- To review and approve major IT deployment projects in all their stages;
- To approve and monitor key projects by measuring result of IT projects in terms of return on investment, etc.;
- To review the status of IS plans and budgets and overall IT performance;
- To review and approve standards, policies and procedures;
- To make decisions on all key aspects of IT deployment and implementation;
- To facilitate implementation of IT security within enterprise;
- To facilitate and resolve conflicts in deployment of IT and ensure availability of a viable communication system between IT and its users; and
- To report to the Board of Directors on IT activities on a regular basis.

Question 2:

COBIT 5 frameworks can be implemented in all sizes of enterprises.

- A comprehensive framework such as COBIT 5 enables enterprises in achieving their objectives for the governance and management of enterprise IT.
- The best practices of COBIT 5 help enterprises to create optimal value from IT by maintaining a balance between realizing benefits and optimizing risk levels and resource use.
- Further, COBIT 5 enables IT to be governed and managed in a holistic manner for the entire enterprise, taking in the full end-to-end business and IT functional areas of responsibility, considering the IT related interests of internal and external stakeholders.
- COBIT 5 helps enterprises to manage IT related risk and ensures compliance, continuity, security and privacy.
- COBIT 5 enables clear policy development and good practice for IT management including increased business user satisfaction.
- The key advantage in using a generic framework such as COBIT 5 is that it is useful for enterprises of all sizes, whether commercial, not-for-profit or in the public sector.
- COBIT 5 supports compliance with relevant laws, regulations, contractual agreements and policies.

Question 3:

The key management practices for assessing and evaluating the system of internal controls in an enterprise are given as follows:

- **Monitor Internal Controls:** Continuously monitor, benchmark and improve the control environment and control framework to meet organizational objectives.
- **Review Business Process Controls Effectiveness:** Review the operation of controls, including a review of monitoring and test evidence to ensure that controls within business processes operate effectively. It also includes activities to maintain evidence of the effective operation of controls through mechanisms such as periodic testing of controls, continuous controls monitoring, independent assessments, command and control centers, and network operations centers. This provides the business with the assurance of control effectiveness to meet requirements related to business, regulatory and social responsibilities.
- **Perform Control Self-assessments:** Encourage management and process owners to take positive ownership of control improvement through a continuing program of self-assessment to evaluate the completeness and effectiveness of management's control over processes, policies and contracts.
- **Identify and Report Control Deficiencies:** Identify control deficiencies and analyze and identify their underlying root causes. Escalate control deficiencies and report to stakeholders.
- **Ensure that assurance providers are independent and qualified:** Ensure that the entities performing assurance are independent from the function, groups or organizations in scope. The entities performing assurance should demonstrate an appropriate attitude and appearance, competence in the skills and knowledge necessary to perform assurance, and adherence to codes of ethics and professional standards
- **Plan Assurance Initiatives:** Plan assurance initiatives based on enterprise objectives and conformance objectives, assurance objectives and strategic priorities, inherent risk resource constraints, and sufficient knowledge of the enterprise.
- **Scope assurance initiatives:** Define and agree with management on the scope of the assurance initiative, based on the assurance objectives.
- **Execute assurance initiatives:** Execute the planned assurance initiative. Report on identified findings. Provide positive assurance opinions, where appropriate, and recommendations for improvement relating to identified operational performance, external compliance and internal control system residual risks.

Question 4:

(vii) Vulnerability: Vulnerability is the weakness in the system safeguards that exposes the system to threats and can be exploited by the attackers. The weakness may be in information system/s, cryptographic systems or other components e.g. system security procedures, hardware design, internal controls that could be exploited by a threat. Vulnerabilities potentially "allow" a threat to harm or exploit the system.

Some examples of vulnerabilities are as follows:

- Leaving the front door unlocked makes the house vulnerable to unwanted visitors.
- Short passwords (less than 6 characters) make the automated information system vulnerable to password cracking or guessing routines.

In other words, Vulnerability is a state in a computing system (or set of systems), which must have at least one condition, out of the following:

- 'Allows an attacker to execute commands as another user' or
- 'Allows an attacker to access data that is contrary to the specified access restrictions for that data' or
- 'Allows an attacker to pose as another entity' or
- 'Allows an attacker to conduct a denial of service'.

Question 5:

COBIT 5 provides key management practices for ensuring compliance with external compliances as relevant to the enterprise. The practices are given as follows:

- **Identify External Compliance Requirements:** On a continuous basis, identify and monitor for changes in local and international laws, regulations, and other external requirements that must be complied with from an IT perspective.
- **Optimize Response to External Requirements:** Review and adjust policies, principles, standards, procedures and methodologies to ensure that legal, regulatory and contractual requirements are addressed and communicated. Consider industry standards, codes of good practice, and best practice guidance for adoption and adaptation
- **Confirm External Compliance:** Confirm compliance of policies, principles, standards, procedures and methodologies with legal, regulatory and contractual requirements
- **Obtain Assurance of External Compliance:** Obtain and report assurance of compliance and adherence with policies, principles, standards, procedures and methodologies. Confirm that corrective actions to address compliance gaps are closed in a timely manner.

Direct tax laws

25 Marks

Question 1:

Any rectification order under section 154 has to be passed within 4 years from the end of financial year in which the order sought to be amended was passed. Order sought to be amended does not necessarily mean the original order. It could be any order including the amended or rectified order. Where any matter has been considered and decided in any proceeding by way of appeal or revision, the authority passing such order may amend the order in relation to any matter other than the matter which has been so considered and decided.

For subsequent rectification, the time limit of 4 years shall be from the end of the financial year in which the earlier rectification order was passed. *[Hind Wire Industries Ltd vs. CIT (1995) 212 ITR 639 (SC)]*. In the given case, the time limit of 4 years has to be reckoned from the end of the financial year in which the order giving effect to the CIT(Appeal)'s decision was passed. Therefore, the rectification order can be passed by the Assessing Officer at any time before expiry of 4 years from the end of the financial year 2013-14 i.e. on or before 31st March, 2018. In this case, the mistake was noticed by the Assessing Officer on 1st September, 2017, for which he issued notice under section 154 for rectifying the mistake. Such rectification is permissible as the time limit of 4 years expires only on 31st March, 2018.

Question 2:

Income chargeable to tax shall be deemed to have escaped assessment for the purpose of section 147, where a person, being a resident other than not ordinarily resident in India, holds, as a beneficial owner or otherwise any asset located outside India or is a beneficiary of any asset located outside India or has a signing authority in any account located outside India. Accordingly, the Assessing Officer can serve a notice under section 148 on such assessee requiring him to furnish a return of income within the specified period, for the purpose of making an assessment, reassessment or recomputation under section 147.

Under section 149, an extended time limit of sixteen years is available for issue of notice under section 148 for an assessment or reassessment, in case income in relation to such assets located outside India has escaped assessment.

As per *Explanation* to section 149, the above provisions, so amended by the Finance Act, 2012, would also apply to any assessment year prior to A.Y.2013-14.

In this case, income chargeable to tax shall be deemed to have escaped assessment for the purpose of section 147, since Nargis has assets located outside India.

Therefore, on this basis, the Assessing Officer formed a belief that the income has escaped assessment and consequently, issued notice under section 148 for 12 assessment years i.e. from A.Y.2005-06 to A.Y.2016-17.

Hence, the Assessing Officer is justified in invoking reassessment provisions in respect of the earlier assessment years also. However, the extended time limit of 16 years for invoking reassessment proceedings would be available only in respect of A.Y.2007-08 and thereafter, since Nargis first purchased an asset outside India only in July 2006.

Accordingly, in view of the above provisions, the action of the Assessing Officer in issuing notices to Nargis under section 148 for ten assessment years i.e., from A.Y. 2007-08 to A.Y. 2016-17 is in order. However, he cannot issue notice under section 148 for A.Y. 2005-06 and A.Y.2006-07, since the time limit of 4 years or 6 years, as the case may be, has since elapsed.

Question 3:

The matter concerning the power of the Settlement Commission to reduce or waive interest chargeable under section 234A, 234B or 234C has been settled by the Supreme Court in *CIT v. Anjum M.H.Ghaswala reported in (2001) 252 ITR 1.*

According to the judgment, sub-section (6) of section 245D is only procedural in nature providing for fixing the term by which the amounts settled under sub-section (4) will have to be paid. It does not empower the Commission either to reduce or waive the interest. Any settlement made by the Commission must be in accordance with the provisions of the Act.

The Settlement Commission does not have the power to reduce or waive the interest levied under sections 234A, 234B and 234C. It does not authorize the waiver or deduction of tax. The levy of interest under sections 234A, 234B or 234C is mandatory in nature and therefore any settlement made must include the interest under these sections. However, as per provisions of section 245F, the Settlement Commission shall have all the powers which are vested in an income-tax authority. Therefore, Settlement Commission can grant relief from the aforesaid interest to the extent of the powers given vide the circulars issued by CBDT under section 119.

Question 4:

A resident can made an application to the Authority of Advance Ruling to seek an advance ruling in the following cases:

(i) Section 245N(b)(iia) enables a resident referred in section 245N(a)(iia) falling within any such class or category of persons as may be notified by the Central Government to make an application to Authority for Advance Rulings. Such notified resident applicant can seek ruling in relation to his tax liability arising out of a transaction which has been undertaken

or is proposed to be undertaken by **such applicant**, and such determination shall include the determination of any question of law or of fact specified in the application.

A resident in relation to his tax liability arising out of one or more transactions valuing ₹ 100 crore or more in total which has been undertaken or proposed to be undertaken would be an applicant for this purpose.

(ii) Section 245N(b)(iii) enables a resident falling within any such class or category of persons as may be notified by the Central Government to make an application for Advance Ruling. Such notified resident applicant can seek ruling in respect of issues relating to computation of total income which is pending before any income-tax authority or the Appellate Tribunal. Such a resident applicant can make an application to seek determination or decision by the AAR on a question of law or a question of fact relating to such computation of total income specified in the application.

"Public sector companies" as defined in section 2(36A) of the Income-tax Act, 1961 have been notified as applicant for this purpose.

(iii) A resident can also make an application seeking advance ruling in relation to the tax liability of a non-resident arising out of a transaction undertaken or proposed to be undertaken by him with such non-resident.

Question 5:

This issue was settled by the Supreme Court in *CIT v. Alagendran Finance Ltd. (2007) 293 ITR 1*. The Supreme Court observed that though there was no doubt that once an order of assessment is reopened, the previous assessment will be held to be set aside and the whole proceedings would start afresh, however, it would not mean that even when the subject-matter of reassessment is distinct and different, the entire proceeding would be deemed to have been reopened. The doctrine of merger would apply only in a case where the subject-matter of reassessment and the subject-matter of assessment are the same. However, in this case, the revision proceedings related to Lease Equalisation Fund, which was not the subject matter of reassessment. Therefore, the doctrine of merger does not apply in this case.

Section 263(2) provides no order shall be made under section 263(1) after the expiry of two years from the end of the financial year in which the order sought to be revised was passed. The period of limitation as referred to in section 263(2) relates to the assessment in which the claim of the assessee as to Lease Equalisation Fund was considered by the Assessing Officer. This issue was not the subject matter of reassessment proceedings.

Accordingly, the period of limitation shall be reckoned with reference to the original assessment order and not from the date of the order of reassessment. Therefore, in this case, the revision proceedings are barred by limitation since the original assessment order was made on 23.12.2015 and the revision should have been made by 31.3.2018.

Note – *The difference between partial merger and total merger has been explained for the understanding of the students. The doctrine of partial merger would apply in the case of section 263.*

The third proviso in section 147, inserted by Finance Act, 2008, provides that the doctrine of partial merger shall apply to reopening in a case where an assessee has filed an appeal etc.

for an assessment year. It has been provided that the Assessing Officer may assess or reassess such income, other than income which has been the subject matter of any appeal or reference or revision, which is chargeable to tax and has escaped assessment. The doctrine of partial merger also holds good for section 154.

However, the concept of total merger would apply in the case of section 264. The Commissioner of Income-tax has no power to revise any order under section 264, if the order has been made subject to an appeal to the Appellate Tribunal, even if the relief claimed in the revision is different from the relief claimed in the appeal and irrespective of the fact whether the appeal is by the assessee or by the Department as the concept of total/complete merger is applicable for section 264.

Indirect Tax Laws

Marks – 25

Timing – 45 Minutes

Question 1:

(i) As per rule 9(1) of the Central Excise Rules, 2002, an importer who issues a CENVATable invoice is required to take registration under the Central Excise Law.

(ii) **No.** Godown or duty free outlet of duty free shop appointed/ licensed as customs warehouse are exempt from taking registration under the Central Excise Law vide *Notification No. 36/2001-C.E. (N.T.) dated 26.06.2001* issued under rule 9 of the Central Excise Rules, 2002.

(iii) Mines engaged in production of specified goods in respect of which there is centralized billing/ accounting system at the premises/office registered under Central Excise Law are exempt from taking registration under the Central Excise Law vide *Notification No. 10/2011-C.E. (N.T.) dated 24.03.2011* issued under rule 9 of the Central Excise Rules, 2002. Coal is one of such specified goods.

Therefore, if such mine has centralized billing/ accounting system at the premises/office registered under Central Excise Law, registration under central excise is not required.

(iv) *Notification No. 11/2013C.E. (NT), dated 2.08.2013* issued under rule 9 of the Central Excise Rules, 2002 exempts the premises used solely for affixing lower ceiling prices on pharmaceutical products from obtaining registration under Central Excise Law provided conditions specified in the notification which exempts the pharmaceutical products from excise duty have been fulfilled.

Therefore, if such conditions have been fulfilled, registration under central excise is not required.

Question 2:

Short levy	Short payment
Short levy arises when the charge itself is done at a lower rate. It may arise out of wrong classification.	Short payment arises out of a short levy or short payment of a correct levy. It is a case of less payment of excise duty than what is due.

Question 3:

(i) As per Rule 8(1) of the Customs, Central Excise Duties and Service Tax Drawback Rules, 1995, no amount of drawback shall be allowed if the rate of drawback is less than 1% of the FOB value, except where the amount of drawback per shipment exceeds ₹ 500. Further, as per section 76(1)(c) of the Customs Act, 1962 drawback is not allowed where the drawback due in respect of any goods is less than ₹ 50.

In the given case, since the rate of duty drawback is not less than 1% and drawback due is ₹ 500 (1% of FOB value) which is more than ₹ 50, duty drawback shall be allowed.

(ii) Section 76(1)(b) of the Customs Act, 1962 *inter alia* provides that no drawback shall be allowed in respect of any goods, the market price of which is less than the amount of drawback due thereon. In this case, the market price of the goods is ₹ 50,000, which is

less than the amount of duty drawback, i.e. 2,000 kgs x ₹ 30 = ₹ 60,000. Hence, no drawback shall be allowed.

(iii) As per rule 8(1) of the Customs, Central Excise Duties and Service Tax Drawback Rules, 1995, no amount of drawback is allowed if the rate of drawback is less than 1% of the FOB value, except where the amount of drawback per shipment exceeds ₹ 500. Further, as per section 76(1)(c) of the Customs Act, 1962, drawback is not allowed where the drawback due in respect of any goods is less than ₹ 50.

In the given case, though the rate of duty drawback is less than 1%, duty drawback shall be allowed as the amount of drawback is ₹ 640 (0.8% of ₹ 80,000) which is more than ₹ 500 and also ₹ 50.

Question 4:

Section 116 of the Customs Act, 1962 imposes a penalty on the person-in-charge of the conveyance *inter alia* for short-landing of the goods at the place of destination and if the deficiency is not accounted for to the satisfaction of the Customs Authorities. Section 2(31) of the Act defines "person-in-charge" to *inter alia* mean in relation to a vessel, the master of the vessel. Section 148 of the Act provides that the agent appointed by the person-in-charge of the conveyance and any person who represents himself to any officer of customs as an agent of any such person-in-charge is held to be liable for fulfillment in respect of the matter in question of all obligations imposed on such person-in-charge by or under this Act and to penalties and confiscation which may be incurred in respect of that matter.

The High Court in the case of *Caravel Logistics Pvt. Ltd. v. Joint Secretary (RA) 2013 (293) ELT 342 (Mad.)* has held that conjoint reading of sections 2(31), 116 and 148 of Customs Act, 1962 makes it clear that in case of short-landing of goods, if penalty is to be imposed on person-in-charge of conveyance/vessel, it can also be imposed on the agent appointed by him. The High Court observed that if the assessee affixed seal on containers after stuffing and took their charge, he stepped into shoes of/acted on behalf of master of vessel (the person-in-charge).

Therefore, in the given case also penalty for short landing of goods can be imposed on Cargo Logistics Pvt. Ltd., the steamer agent of the vessel, Queen Mary Utah.

Question 5:

According to section 127B of the Customs Act 1962, the following conditions are to be fulfilled for filing an application for settlement of cases:

(i) the applicant has filed a bill of entry, or a shipping bill, or a bill of export, or made a baggage declaration, or a label or declaration accompanying the goods imported or exported through post or courier, as the case may be, and in relation to such document or documents, a show cause notice has been issued to him by the proper officer.

(ii) the additional duty accepted is more than ₹ 3 lakhs.

(iii) the applicant has paid the additional amount of customs duty accepted by him alongwith interest due under section 28AA.

(iv) the case is not pending with CESTAT or any Court.

(v) the application does not relate to goods to which section 123 applies or to goods relation to which any offence under the Narcotic Drugs and Psychotropic Substance Act, 1985 has been committed.

(vi) the application is not for the interpretation of the classification of the goods under th Customs Tariff Act, 1975

Further, application before Settlement Commission can be made only when adjudication pending.