PAPER –1: FINANCIAL REPORTING

QUESTIONS

Analysis of Financial Statements/ Ind AS 101

1. HIM Limited having net worth of ₹ 250 crores is required to adopt Ind AS from 1 April, 20X2 in accordance with the Companies (Indian Accounting Standard) Rules 2015.

   Rahul, the senior manager, of HIM Ltd. has identified following issues which need specific attention of CFO so that opening Ind AS balance sheet as on the date of transition can be prepared:

   Issue 1 : As part of Property, Plant and Equipment, Company has elected to measure land at its fair value and want to use this fair value as deemed cost on the date of transition. The carrying value of land as on the date of transition was ₹ 5,00,000. The land was acquired for a consideration of ₹ 5,00,000. However, the fair value of land as on the date of transition was ₹ 8,00,000.

   Issue 2 : Under Ind AS, the Company has designated mutual funds as investments at fair value through profit or loss. The value of mutual funds as per previous GAAP was ₹ 4,00,000 (at cost). However, the fair value of mutual funds as on the date of transition was ₹ 5,00,000.

   Issue 3 : Company had taken a loan from another entity. The loan carries an interest rate of 7% and it had incurred certain transaction costs while obtaining the same. It was carried at cost on its initial recognition. The principal amount is to be repaid in equal instalments over the period of loan. Interest is also payable at each year end. The fair value of loan as on the date of transition is ₹ 1,80,000 as against the carrying amount of loan which at present equals ₹ 2,00,000.

   Issue 4 : The company has declared dividend of ₹ 30,000 for last financial year. On the date of transition, the declared dividend has already been deducted by the accountant from the company's 'Reserves & Surplus' and the dividend payable has been grouped under 'Provisions'. The dividend was only declared by board of directors at that time and it was not approved in the annual general meeting of shareholders. However, subsequently when the meeting was held it was ratified by the shareholders.

   Issue 5 : The company had acquired intangible assets as trademarks amounting to ₹ 2,50,000. The company assumes to have indefinite life of these assets. The fair value of the intangible assets as on the date of transition was ₹ 3,00,000. However, the company wants to carry the intangible assets at ₹ 2,50,000 only.

   Issue 6 : After consideration of possible effects as per Ind AS, the deferred tax impact is computed as ₹ 25,000. This amount will further increase the portion of deferred tax liability. There is no requirement to carry out the separate calculation of deferred tax on account of Ind AS adjustments.

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Management wants to know the impact of Ind AS in the financial statements of company for its general understanding.

Prepare Ind AS Impact Analysis Report (Extract) for HIM Limited for presentation to the management wherein you are required to discuss the corresponding differences between Earlier IGAAP (AS) and Ind AS against each identified issue for preparation of transition date balance sheet. Also pass journal entry for each issue.

Ind AS 2

2. On 1 January 20X1 an entity accepted an order for 7,000 custom-made corporate gifts.

On 3 January 20X1 the entity purchased raw materials to be consumed in the production process for ₹ 5,50,000, including ₹ 50,000 refundable purchase taxes. The purchase price was funded by raising a loan of ₹ 5,55,000 (including ₹ 5,000 loan-raising fees). The loan is secured by the inventories.

During January 20X1 the entity designed the corporate gifts for the customer.

Design costs included:

- cost of external designer = ₹ 7,000; and
- labour = ₹ 3,000.

During February 20X1 the entity'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; and
- depreciation of plant used to perform the modifications = ₹ 5,000.

During February 20X1 the entity incurred the following additional costs in manufacturing the customised corporate gifts:

- consumable stores = ₹ 55,000;
- labour = ₹ 65,000; and
- depreciation of plant used to manufacture the customised corporate gifts = ₹ 15,000.

The customised corporate gifts were ready for sale on 1 March 20X1. No abnormal wastage occurred in the development and manufacture of the corporate gifts.

Compute the cost of the inventory? Substantiate your answer with appropriate reasons and calculations, wherever required.

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Ind AS 8

3. In 20X3-20X4, after the entity's 31 March 20X3 annual financial statements were approved for issue, a latent defect in the composition of a new product manufactured by the entity was discovered (that is, a defect that could not be discovered by reasonable or customary inspection). As a result of the latent defect the entity incurred ₹100,000 in unanticipated costs for fulfilling its warranty obligation in respect of sales made before 31 March 20X3. An additional ₹20,000 was incurred to rectify the latent defect in products sold during 20X3-20X4 before the defect was detected and the production process rectified, ₹5,000 of which relates to items of inventory at 31 March 20X3. The defective inventory was reported at cost ₹ 15,000 in the 20X2-20X3 financial statements when its selling price less costs to complete and sell was estimated at ₹18,000. The accounting estimates made in preparing the 31 March 20X3 financial statements were appropriately made using all reliable information that the entity could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

   Analyse the above situation in accordance with relevant Ind AS.

Ind AS 38

4. PQR Ltd. is a gaming developer company. Few years back, it developed a new game called 'Cloud9'. This game sold over 10,00,000 copies around the world and was extremely profitable. Due to its popularity, PQR Ltd. released a new game in the 'Cloud9' series every year. The games continue to be the bestseller. Based on Management's expectations, estimates of cash flow projections for the 'cloud9 videogame series' over the next five years have been prepared. Based on these projections, PQR Ltd. believes that cloud9 series brand should be recognised at INR 20,00,000 in its financial statement. PQR Ltd. has also paid INR 10,00,000 to MNC Ltd. to acquire rights of another video game series called the 'Headspace' videogame series. The said series have huge demand in the market.

   Discuss the accounting treatment of the above in the financial statements of PQR Ltd.

Ind AS 37 / Ind AS 115

5. A manufacturer gives warranties to the purchasers of its goods. Under the terms of the warranty, the manufacturer undertakes to make good, by repair or replacement, manufacturing defects that become apparent within three years from the date of sale to the purchasers.

   On 30 April 20X1, a manufacturing defect was detected in the goods manufactured by the entity between 1 March 20X1 and 30 April 20X1.

   At 31 March 20X1 (the entity's reporting date), the entity held approximately one week's sales in inventories.

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The entity's financial statements for the year ended 31 March 20X1 have not yet been finalised.

Three separate categories of goods require separate consideration:

Category 1—defective goods sold on or before 31 March 20X1

Category 2—defective goods held on 31 March 20X1

Category 3—defective goods manufactured in 20X1-20X2

State the accounting treatment of the above categories in accordance with relevant Ind AS.

Ind AS 16

6. An entity has the following items of property, plant and equipment:

- Property A — a vacant plot of land on which it intends to construct its new administration headquarters;
- Property B — a plot of land that it operates as a landfill site;
- Property C — a plot of land on which its existing administration headquarters are built;
- Property D — a plot of land on which its direct sales office is built;
- Properties E1–E10 — ten separate retail outlets and the land on which they are built;
- Equipment A — computer systems at its headquarters and direct sales office that are integrated with the point of sale computer systems in the retail outlets;
- Equipment B — point of sale computer systems in each of its retail outlets;
- Furniture and fittings in its administrative headquarters and its sales office;
- Shop fixtures and fittings in its retail outlets.

How many classes of property, plant and equipment must the entity disclose?

Ind AS 23 / Ind AS 109

7. How will you capitalise the interest when qualifying assets are funded by borrowings in the nature of bonds that are issued at discount?

Y Ltd. issued at the start of year 1, 10% (interest paid annually and having maturity period of 4 years) bonds with a face value of ₹ 2,00,000 at a discount of 10% to finance a qualifying asset which is ready for intended use at the end of year 2.

Compute the amount of borrowing costs to be capitalized if the company amortizes discount using Effective Interest Rate method by applying 13.39% p.a. of EIR.

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Ind AS 7

8. From the following data, identify the nature of activities as per Ind AS 7.

S.no.	Nature of transaction
1	Cash paid to employees
2	Cash paid for development of property costs
3	Borrowings repaid
4	Cash paid to suppliers
5	Loan to Director
6	Bonus shares issued
7	Dividends paid
8	Cash received from trade receivables
9	Proceeds from sale of PPE
10	Depreciation of PPE
11	Advance received from customers
12	Purchased goodwill
13	Payment of promissory notes

Ind AS 40

9. X Ltd owned a land property whose future use was not determined as at 31 March 20X1. How should the property be classified in the books of X Ltd as at 31 March 20X1?

   During June 20X1, X Ltd commenced construction of office building on it for own use. Presuming that the construction of the office building will still be in progress as at 31 March 20X2

   (a) How should the land property be classified by X Ltd in its financial statements as at 31 March 20X2?

   (b) Will there be a change in the carrying amount of the property resulting from any change in use of the investment property?

   (c) Whether the change in classification to, or from, investment properties is a change in accounting policy to be accounted for in accordance with Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors?

   (d) Would your answer to (a) above be different if there were to be a management intention to commence construction of an office building for own use; however, no construction activity was planned by 31 March 20X2?

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Ind AS 115

10. A property sale contract includes the following:
    (a) Common areas
    (b) Construction services and building material
    (c) Property management services
    (d) Golf membership
    (e) Car park
    (f) Land entitlement

    Analyse whether the above items can be considered as separate performance obligations as per the requirements of Ind AS 115?

Ind AS 116

11. Entity X is an Indian entity whose functional currency is Indian Rupee. It has taken a plant on lease from Entity Y for 5 years to use in its manufacturing process for which it has to pay annual rentals in arrears of USD 10,000 every year. On the commencement date, exchange rate was USD = ₹ 68. The average rate for Year 1 was ₹ 69 and at the end of year 1, the exchange rate was ₹ 70. The incremental borrowing rate of Entity X on commencement of the lease for a USD borrowing was 5% p.a.

    How will entity X measure the right of use (ROU) asset and lease liability initially and at the end of Year 1?

Ind AS 102

12. Company P is a holding company for company B. A group share-based payment is being organized in which Parent issues its own equity shares to the employees of company B. The details are as below –

Number of Employees of Company B	100
Grant date fair value of share	₹ 87
Number of shares granted to each employee	25
Vesting conditions	Immediately
Face value per share	₹ 10

    Pass the journal entries in the books of company P & company B.

Ind AS 103

13. Bima Ltd. acquired 65% of shares on 1 June, 20X1 in Nafa Ltd. which is engaged in production of components of machinery. Nafa Ltd. has 1,00,000 equity shares of ₹ 10 each. The quoted market price of shares of Nafa Ltd. was ₹ 12 on the date of

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acquisition. The fair value of Nafa Ltd.'s identifiable net assets as on 1 June, 20X1 was ₹ 80,00,000.

Bima Ltd. wired ₹ 50,00,000 in cash and issued 50,000 equity shares as purchase consideration on the date of acquisition. The quoted market price of shares of Bima Ltd. on the date of issue was ₹ 25 per share.

Bima Ltd. also agrees to pay additional consideration of ₹ 15,00,000, if the cumulative profit earned by Nafa Ltd. exceeds ₹ 1 crore over the next three years. On the date of acquisition, Nafa Ltd. assessed and determined that it is considered probable that the extra consideration will be paid. The fair value of this consideration on the date of acquisition is ₹ 9,80,000. Nafa Ltd. incurred ₹ 1,50,000 in relation to the acquisition. It measures Non-controlling interest at fair value.

How will the acquisition of Nafa Ltd. be accounted by Bima Ltd., under Ind AS 103? Prepare detailed workings and pass the necessary journal entry.

Ind AS 41

14. Analyse whether the following activities fall within the scope of Ind AS 41 with proper reasoning:

- Managing animal-related recreational activities like Zoo
- Fishing in the ocean
- Fish farming
- Development of living organisms such as cells, bacteria and viruses
- Growing of plants to be used in the production of drugs
- Purchase of 25 dogs for security purpose of the company’s premises.

Ind AS 109

15. On 1 April 20X1, Sun Limited guarantees a ₹10,00,000 loan of Subsidiary – Moon Limited, which Bank STDK has provided to Moon Limited for three years at 8%.

Interest payments are made at the end of each year and the principal is repaid at the end of the loan term.

If Sun Limited had not issued a guarantee, Bank STDK would have charged Moon Limited an interest rate of 11%. Sun Limited does not charge Moon Limited for providing the guarantee.

On 31 March 20X2, there is 1% probability that Moon Limited may default on the loan in the next 12 months. If Moon Limited defaults on the loan, Sun Limited does not expect to recover any amount from Moon Limited.

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On 31 March 20X3, there is 3% probability that Moon Limited may default on the loan in the next 12 months. If Moon Limited defaults on the loan, Sun Limited does not expect to recover any amount from Moon Limited.

Provide the accounting treatment of financial guarantee as per Ind AS 109 in the books of Sun Ltd., on initial recognition and in subsequent periods till 31 March 20X3.

Ind AS 1

16. An entity has the following trial balance line items. How should these items be classified, i.e., current or non-current as per Ind AS 1?

    (a) Receivables (viz., receivable under a contract of sale of goods in which an entity deals)

    (b) Advance to suppliers

    (c) Income tax receivables [other than deferred tax]

    (d) Insurance spares

Ind AS 21 & Ind AS 103

17. Monsoon Limited acquired, on 30 September, 20X2, 70% of the share capital of Mark Limited, an entity registered as company in Germany. The functional currency of Monsoon Limited is Indian Rupee and its financial year ends on 31 March, 20X3.

    The fair value of the net assets of Mark Limited was 23 million EURO and the purchase consideration paid is 17.5 million EURO on 30 September, 20X2.

    The exchange rates as on 30 September, 20X2 was ₹ 82 per EURO and at 31 March, 20X3 was ₹ 84 per EURO.

    On acquisition of Mark limited, what is the value at which the goodwill / capital reserve has to be recognized in the financial statements of Monsoon Limited as on 31 March 20X3?

Ind AS 19

18. At 1 April, 20X0, the fair value of the Plan Assets was ₹ 10,00,000. The Plan paid benefits of ₹ 1,90,000 and received contributions of ₹ 4,90,000 on 30 September, 20X0. The company computes the Fair Value of Plan Assets to be ₹ 15,00,000 as on 31 March, 20X1 and the Present Value of the Defined Benefit Obligation to amount to ₹ 14,79,200 on the same date. Actuarial losses on defined benefit obligation were ₹ 6,000.

    Compounding happens half-yearly. The normal interest rate for 6 months period is 10%, while the effective interest rate for 12 months period is based on the following data:

    At 1 April, 20X0, the company made the following estimates based on market prices at that date:

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Particulars	%
Interest and Dividend Income, after tax payable by the fund	9.25
Add: Realized and Unrealized Gains on Plan Assets (after tax)	2.00
Less: Administration Costs	(1.00)
Expected Rate of Return	10.25

Determine actual return and expected return on plan asset. Also compute amount to be recognized in 'Other Comprehensive Income' in this case.

Ind AS 12

19. The entity has an identifiable asset ASSOTA with a carrying amount of ₹ 10,00,000. Its recoverable amount is ₹ 6,50,000. The tax base of ASSOTA is ₹ 8,00,000 and the tax rate is 30%. Impairment losses are not tax deductible. Entity expects to continue to earn profits in future.

    For the identifiable asset ASSOTA, what would be the impact on the deferred tax asset/ liability at the end of the period?

Ind AS 36

20. On 31 March 20X1, Vision Ltd acquired 80% of the equity shares of Mission Ltd for ₹ 190 million. The fair values of the net assets of Mission Ltd that were included in the consolidated statement of financial position of Vision Ltd at 31 March 20X1 were ₹ 200 million. It is the Group's policy to value the non-controlling interest in subsidiaries at the date of acquisition at its proportionate share of the fair value of the subsidiaries' identifiable net assets.

    On 31 March 20X4, Vision Ltd carried out its annual review of the goodwill on consolidation of Mission Ltd and found evidence of impairment. No impairment had been evident when the reviews were carried out at 31 March 20X2 and 31 March 20X3. The review involved allocating the assets of Mission Ltd into three cash-generating units and computing the value in use of each unit. The carrying values of the individual units before any impairment adjustments are given below:

	Unit A ₹ in million	Unit B ₹ in million	Unit C ₹ in million
Intangible assets	30	10	-
Property, Plant and Equipment	80	50	60
Current Assets	60	30	40
Total	170	90	100
Value in use of unit	180	66	104

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It was not possible to meaningfully allocate the goodwill on consolidation to the individual cash generating units but all the other net assets of Mission Ltd are allocated in the table shown above.

The intangible assets of Mission Ltd have no ascertainable market value but all the current assets have a market value that is at least equal to their carrying value. The value in use of Mission Ltd as a single cash-generating unit on 31 March 20X4 is ₹ 350 million.

Discuss and compute the accounting treatment of impairment of goodwill as per Ind AS 36?

SUGGESTED ANSWERS

1. Preliminary Impact Assessment on Transition to Ind AS in HIM Limited's Financial Statements

Issue 1: Fair value as deemed cost for property plant and equipment:

Accounting Standards (Erstwhile IGAAP)	Ind AS	Impact on Company's financial statements
As per AS 10, Property, Plant and Equipment is recognised at cost less depreciation.	Ind AS 101 allows entity to elect to measure Property, Plant and Equipment on the transition date at its fair value or previous GAAP carrying value (book value) as deemed cost.	The company has decided to adopt fair value as deemed cost in this case. Since fair value exceeds book value, so the book value should be brought up to fair value. The resulting impact of fair valuation of land ₹ 3,00,000 should be adjusted in other equity.

Journal Entry on the date of transition

Particulars	Debit (₹)	Credit (₹)
Property Plant and Equipment Dr.	3,00,000	
To Revaluation Surplus (OCI- Other Equity)		3,00,000

Issue 2: Fair valuation of Financial Assets:

Accounting Standards (Erstwhile IGAAP)	Ind AS	Impact on Company's financial statements
As per Accounting Standard, investments	On transition, financial assets including	All financial assets (other than Investment in

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are measured at lower of cost and fair value.	investments are measured at fair values except for investments in subsidiaries, associates and JVs' which are recorded at cost.	subsidiaries, associates and JVs' which are recorded at cost) are initially recognized at fair value. The subsequent measurement of such assets are based on its categorization either Fair Value through Profit & Loss (FVTPL) or Fair Value through Other Comprehensive Income (FVTOCI) or at Amortised Cost based on business model assessment and contractual cash flow characteristics. Since investment in mutual fund are designated at FVTPL, increase of ₹ 1,00,000 in mutual funds fair value would increase the value of investments with corresponding increase to Retained Earnings.

Journal Entry on the date of transition

Particulars	Debit (₹)	Credit (₹)
Investment in mutual funds Dr.	1,00,000	
To Retained earnings		1,00,000

Issue 3: Borrowings - Processing fees/transaction cost:

Accounting Standards (Erstwhile IGAAP)	Ind AS	Impact on Company's financial statements
As per AS, such expenditure is charged to Profit and loss account or capitalised	As per Ind AS, such expenditure is amortised over the period of the loan. Ind AS 101 states that if it	Fair value as on the date of transition is ₹ 1,80,000 as against its book value of ₹ 2,00,000. Accordingly,

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as the case may be	is impracticable for an entity to apply retrospectively the effective interest method in Ind AS 109, the fair value of the financial asset or the financial liability at the date of transition to Ind AS shall be the new gross carrying amount of that financial asset or the new amortised cost of that financial liability.	the difference of ₹ 20,000 is adjusted through retained earnings.

Journal Entry on the date of transition

Particulars	Debit (₹)	Credit (₹)
Borrowings / Loan payable Dr.	20,000	
To Retained earnings		20,000

Issue 4: Proposed dividend:

Accounting Standards (Erstwhile IGAAP)	**Ind AS**	**Impact on Company's financial statements**
As per AS, provision for proposed divided is made in the year when it has been declared and approved.	As per Ind AS, liability for proposed dividend is recognised in the year in which it has been declared and approved.	Since dividend should be deducted from retained earnings during the year when it has been declared and approved. Therefore, the provision declared for preceding year should be reversed (to rectify the wrong entry). Retained earnings would increase proportionately due to such adjustment

Journal Entry on the date of transition

Particulars	Debit (₹)	Credit (₹)
Provisions Dr.	30,000	
To Retained earnings		30,000

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Issue 5 : Intangible assets:

Accounting Standards (Erstwhile IGAAP)	**Ind AS**	**Impact on Company's financial statements**
The useful life of an intangible asset cannot be indefinite under IGAAP principles. The Company amortised brand/trademark on a straight line basis over maximum of 10 years as per AS 26.	The useful life of an intangible asset like brand/trademark can be indefinite. Not required to be amortised and only tested for impairment. Company can avail the exemption given in Ind AS 101 as on the date of transition to use the carrying value as per previous GAAP.	Consequently, there would be no impact as on the date of transition since company intends to use the carrying amount instead of book value at the date of transition.

Issue 6: Deferred tax

Accounting Standards (Erstwhile IGAAP)	**Ind AS**	**Impact on Company's financial statements**
As per AS, deferred taxes are accounted as per income statement approach.	As per Ind AS, deferred taxes are accounted as per balance sheet approach.	On date of transition to Ind AS, deferred tax liability would be increased by ₹ 25,000.

Journal Entry on the date of transition

Particulars		Debit (₹)	Credit (₹)
Retained earnings	Dr.	25,000	
To Deferred tax liability			25,000

2. **Statement showing computation of inventory cost**

Particulars	**Amount (₹)**	**Remarks**
Costs of purchase	5,00,000	Purchase price of raw material [purchase price (₹ 5,50,000) less refundable purchase taxes (₹ 50,000)]
Loan-raising fee	–	Included in the measurement of the liability

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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	–	Recognised as an expense in profit or loss
Total cost of inventories	**6,82,000**	

Working Note:

Costs of testing product designed for specific customer:

₹ 21,000 material (ie net of the ₹ 3,000 recovered from the sale of the scrapped output) + ₹ 11,000 labour + ₹ 5,000 depreciation.

3. Ind AS 8 is applied in selecting and applying accounting policies, and accounting for changes in accounting policies, changes in accounting estimates and corrections of prior period errors.

A change in accounting estimate is an adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset. This change in accounting estimate is an outcome of the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities. Changes in accounting estimates result from new information or new developments and, accordingly, are not corrections of errors.

Further, the effect of change in an accounting estimate, shall be recognised prospectively by including it in profit or loss in: (a) the period of the change, if the change affects that period only; or (b) the period of the change and future periods, if the change affects both.

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.

On the basis of above provisions, the given situation would be dealt as follows:

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The defect was neither known nor reasonably possible to detect at 31 March 20X3 or before the financial statements were approved for issue, so understatement of the warranty provision ₹ 1,00,000 and overstatement of inventory ₹ 2,000 (Note 1) in the 31 March 20X3 financial statements are not a prior period errors.

The effects of the latent defect that relate to the entity's financial position at 31 March 20X3 are changes in accounting estimates.

In preparing its financial statements for 31 March 20X3, the entity made the warranty provision and inventory valuation appropriately using all reliable information that the entity could reasonably be expected to have obtained and had taken into account the same in the preparation and presentation of those financial statements.

Consequently, the additional costs are expensed in calculating profit or loss for 20X3-20X4.

Working Note:

Inventory is measured at the lower of cost (ie ₹ 15,000) and fair value less costs to complete and sell (ie ₹ 18,000 originally estimated minus ₹ 5,000 costs to rectify latent defect) = ₹ 13,000.

4. In order to determine the accounting treatment of 'cloud9 videogame series' and 'Headspace', definition of asset and intangible asset given in Ind AS 38 may be noted:

"An asset is a resource:

(a) controlled by an entity as a result of past events; and

(b) from which future economic benefits are expected to flow to the entity."

"An intangible asset is an identifiable non-monetary asset without physical substance."

In accordance with the above, for recognising an intangible asset, an entity must be able to demonstrate that the item satisfies the criteria of identifiability, control and existence of future economic benefits.

In order to determine whether 'cloud9 videogame series' meet the aforesaid conditions, following provisions of Ind AS 38 regarding Internally Generated Intangible Assets may be noted:

As per paragraph 63 and 64 of Ind AS 38, internally generated brands, mastheads, publishing titles, customer lists and items similar in substance should not be recognised as intangible assets. Expenditure on such items cannot be distinguished from the cost of developing the business as a whole. Therefore, such items are not recognised as intangible assets.

Accordingly, though the cash flow projections suggest that the cloud9 brand will lead to future economic benefits, yet the asset has been internally generated; therefore, the Cloud9 brand cannot be recognised as intangible asset in the financial statements.

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In order to determine whether 'Headspace' meet the aforesaid conditions, following provisions of Ind AS 38 regarding 'Separately acquired Intangible Assets' should be analused.

As per paragraphs 25 and 26 of Ind AS 38, normally, the price an entity pays to acquire separately an intangible asset will reflect expectations about the probability that the expected future economic benefits embodied in the asset will flow to the entity. In other words, the entity expects there to be an inflow of economic benefits, even if there is uncertainty about the timing or the amount of the inflow. Therefore, the probability recognition criterion in paragraph 21(a) is always considered to be satisfied for separately acquired intangible assets. In addition, the cost of a separately acquired intangible asset can usually be measured reliably. This is particularly so when the purchase consideration is in the form of cash or other monetary assets.

The Headspace game has been purchased for INR 10,00,000 and it is expected to generate future economic benefits to the entity. Since Headspace game is a separately acquired asset and the future benefits are expected to flow to the entity, therefore, an intangible asset should be recognised in respect of the 'Headspace' asset at its cost of INR 10,00,000. After initial recognition, either cost model or revaluation model can be used to measure headspace intangible asset as per guidance given in paragraphs 74-87 of Ind AS 38. In accordance with this, Headspace intangible asset should be carried at its cost/revalued amount (as the case may be) less any accumulated amortisation and any accumulated impairment losses.

5. Category 1—defective goods sold on or before 31 March 20X1

If customer has the option to purchase warranty separately, the warranty is a distinct service because the entity promises to provide the service to the customer in addition to the product that has the functionality described in the contract. In that case, entity shall account for the promised warranty as a performance obligation and allocate a portion of the transaction price to that performance obligation.

If a customer does not have the option to purchase a warranty separately, an entity shall account for the warranty in accordance with Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets,* unless it provides the customer with a service in addition to the assurance that the product complies with agreed-upon specifications. If that is the case, then, the promised service is a performance obligation. Entity shall allocate the transaction price to the product and the service.

If an entity promises both an assurance-type warranty and a service-type warranty but cannot reasonably account for them separately, the entity shall account for both of the warranties together as a single performance obligation.

A law that requires an entity to pay compensation if its products cause harm or damage does not give rise to a performance obligation. The entity shall account for such obligations in accordance with Ind AS 37.

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Category 2—defective goods held on 31 March 20X1

At 31 March 20X1 the entity did not have a present obligation to make good the unsold defective goods that it held in inventories. Accordingly, at 31 March 20X1 the entity should not recognise a provision in respect of the defective inventories. However, the entity should test the inventories for impairment in accordance with Ind AS 36, *Impairment of Assets*.

For this category, the detection of the manufacturing defect in April 20X1 is an adjusting event after the end of the reporting period as per Ind AS 10, *Events after the End of the Reporting Period*. It provides evidence of a manufacturing defect in inventories held at 31 March 20X1.

Category 3—defective goods manufactured in 20X1-20X2

At 31 March 20X1 the entity did not have a present obligation to make good any defective goods that it might manufacture in the future. Accordingly, at 31 March 20X1 the entity should not recognise a provision in respect of the defective goods manufactured in 20X1-20X2.

For this category, the detection of the manufacturing defect in April 20X1 is a non-adjusting event after the end of the reporting period as per Ind AS 10, *Events After the End of the Reporting Period*.

6. To answer this question one must make a materiality judgement.

A class of assets is defined as a grouping of assets of a similar nature and use in an entity's operations.

The nature of land without a building is different to the nature of land with a building.

Consequently, land without a building is a separate class of asset from land and buildings. Furthermore, the nature and use of land operated as a landfill site is different from vacant land. Hence, the entity should disclose Property A separately. The entity must apply judgement to determine whether the entity's retail outlets are sufficiently different in nature and use from its office buildings, and thus constitute a separate class of land and buildings.

The computer equipment is integrated across the organisation and would probably be classified as a single separate class of asset.

Furniture and fittings used for administrative purposes could be sufficiently different to shop fixtures and fittings in retail outlets. Hence, they should be classified in two separate classes of assets.

7. Capitalisation Method

As per the Standard, borrowing costs may include interest expense calculated using the effective interest method. Further, capitalisation of borrowing cost should cease where substantially all the activities necessary to prepare the qualifying asset for its intended

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use or sale are complete.

Thus, only that portion of the amortized discount should be capitalised as part of the cost of a qualifying asset which relates to the period during which acquisition, construction or production of the asset takes place.

Capitalisation of Interest

Hence based on the above explanation the amount of borrowing cost of year 1 & 2 are to be capitalised and the borrowing cost relating to year 3 & 4 should be expensed.

Quantum of Borrowing

The value of the bond to Y Ltd. is the transaction price ie ₹ 1,80,000 (2,00,000 – 20,000)

Therefore, Y Ltd will recognize the borrowing at ₹ 1,80,000.

Computation of the amount of Borrowing Cost to be Capitalised

Y Ltd will capitalise the interest (borrowing cost) using the effective interest rate of 13.39% for two years as the qualifying asset is ready for intended use at the end of the year 2, the details of which are as follows:

Year	*Opening Borrowing*	*Interest expense @ 13.39% to be capitalised*	*Total*	*Interest paid*	*Closing Borrowing*
	(1)	*(2)*	*(3)*	*(4)*	*(5) = (3) – (4)*
1	1,80,000	24,102	2,04,102	20,000	1,84,102
2	1,84,102	24,651	2,08,753	20,000	1,88,753
		48,753			

Accordingly, borrowing cost of ₹ 48,753 will be capitalized to the cost of qualifying asset.

8.

S. No.	**Nature of transaction**	**Activity as per Ind AS 7**
1	Cash paid to employees	Operating activity
2	Cash paid for development costs	Investing activity
3	Borrowings repaid	Financing activity
4	Cash paid to suppliers	Operating activity
5	Loan to Director	Investing activity
6	Bonus shares issued	Non-cash item
7	Dividends paid	Financing activity
8	Cash received from trade receivables	Operating activity
9	Proceeds from sale of PPE	Investing activity

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10	Depreciation of PPE	Non-cash item
11	Advance received from customers	Operating activity
12	Purchased goodwill	Investing activity
13	Payment of promissory notes	Financing activity

9. As per paragraph 8(b) of Ind AS 40, any land held for currently undetermined future use, should be classified as an investment property. Hence, in this case, the land would be regarded as held for capital appreciation. Hence the land property should be classified by X Ltd as investment property in the financial statements as at 31 March 20X1.

As per Para 57 of the Standard, an entity can change the classification of any property to, and from, an investment property when and only when evidenced by a change in use. A change occurs when the property meets or ceases to meet the definition of investment property and there is evidence of the change in use. Mere management's intention for use of the property does not provide evidence of a change in use.

(a) Since X Ltd has commenced construction of office building on it for own use, the property should be reclassified from investment property to owner occupied as at 31 March 20X2.

(b) As per Para 59, transfers between investment property, owner occupied and inventories do not change the carrying amount of the property transferred and they do not change the cost of the property for measurement or disclosure purposes.

(c) No. The change in classification to, or from, investment properties is due to change in use of the property. No retrospective application is required and prior period's financial statements need not be re-stated.

(d) Mere management intentions for use of the property do not evidence change in use. Since X Ltd has no plans to commence construction of the office building during 20X1-20X2, the property should continue to be classified as an investment property by X Ltd in its financial statements as at 31 March 20X2.

10. Paragraph 22 of Ind AS 115 provides that at contract inception, an entity evaluates the promised goods or services to determine which goods or services (or bundle of goods or services) are distinct and therefore constitute a performance obligation.

A performance obligation is a promise in a contract to transfer to the customer either:

- a good or service (or a bundle of goods or services) that is distinct; and
- series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

As per paragraph 27 of Ind AS 115, a good or service that is promised to a customer is distinct if both of the following criteria are met:

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(a) the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (i.e. the good or service is capable of being distinct); and

(b) the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (i.e. the promise to transfer the good or service is distinct within the context of the contract).

Each performance obligation is required to be accounted for separately.

Based on the above guidance, the following table discusses whether the common goods and services in property sale contract should be considered as separate performance obligation or not:

Goods/Service	**Whether a separate Performance obligation (PO) or not**	**Reason**
Common areas	Unlikely to be separate PO	Common areas are unlikely to be a separate performance obligation because the interests received in common areas are typically undivided interests that are not separable from the property itself. However, if the common areas were sold separately by the developer, then they could be considered as a separate performance obligation provided that it is distinct in the context of the contract.
Construction services and building material	Unlikely to be separate PO	Construction services and building materials can meet the first criterion as they are items that can be used in conjunction with other readily available goods or services. However, the developer would be considered to be providing a significant integration service as it is bringing together all the separate elements to deliver a complete building.

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Property management services and Golf membership	Likely to be separate PO	Property management services and golf membership are likely to be separate performance obligations as they may be used in isolation or with the property already acquired, i.e., management services can be used with the property. These types of services are not significantly customised, integrated with, or dependent on the property. This is because there is no change in their function with or without the property. Also, a property management service could be undertaken by a third party.
Car park and Land entitlement	Analysis required	Items such as car parks and land entitlements generally meet the first criterion – i.e., capable of being distinct – as the buyer benefits from them on their own. Whether the second criterion is met depends on the facts and circumstances. For example, if the land entitlement can be sold separately or pledged as security as a separate item, it may indicate that it is not highly dependent on, or integrated with, other rights received in the contract. In an apartment scenario, the customer can receive an undivided interest in the land on which the apartment block sits. This type of right is generally considered as highly inter-related with the apartment itself.*

* However, if title to the land is transferred to the buyer separately – for example in a single party development – then the separately identifiable criterion may be met.

PS: Other facts and circumstances of each contract should also be carefully examined to determine performance obligations.

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11. On initial measurement, Entity X will measure the lease liability and ROU asset as under:

Year	Lease Payments (USD)	Present Value factor @ 5%	Present Value of Lease Payment	Conversion rate (spot rate)	INR value
1	10,000	0.952	9,520	68	6,47,360
2	10,000	0.907	9,070	68	6,16,760
3	10,000	0.864	8,640	68	5,87,520
4	10,000	0.823	8,230	68	5,59,640
5	10,000	0.784	7,840	68	5,33,120
Total			**43,300**		**29,44,400**

As per Ind AS 21, The Effects of Changes in Foreign Exchange Rates, monetary assets and liabilities are restated at each reporting date at the closing rate and the difference due to foreign exchange movement is recognised in profit and loss whereas non-monetary assets and liabilities carried measured in terms of historical cost in foreign currency are not restated.

Accordingly, the ROU asset in the given case being a non-monetary asset measured in terms of historical cost in foreign currency will not be restated but the lease liability being a monetary liability will be restated at each reporting date with the resultant difference being taken to profit and loss.

At the end of Year 1, the lease liability will be measured in terms of USD as under:

Lease Liability:

Year	Initial Value (USD) (a)	Lease Payment (b)	Interest @ 5% (c) = (a x 5%)	Closing Value (USD) (d = a + c - b)
1	43,300	10,000	2,165	35,465

Interest at the rate of 5% will be accounted for in profit and loss at average rate of ₹ 69 (i.e., USD 2,165 x 69) = ₹ 1,49,385.

Particulars		Dr. (₹)	Cr. (₹)
Interest Expense	Dr.	1,49,385	
To Lease liability			1,49,385

Lease payment would be accounted for at the reporting date exchange rate, i.e. ₹ 70 at the end of year 1

Particulars		Dr. (₹)	Cr. (₹)
Lease liability	Dr.	7,00,000	
To Cash			7,00,000

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As per the guidance above under Ind AS 21, the lease liability will be restated using the reporting date exchange rate i.e., ₹ 70 at the end of Year 1. Accordingly, the lease liability will be measured at ₹ 24,82,550 (35,465 x ₹ 70) with the corresponding impact due to exchange rate movement of ₹ 88,765 (24,82,550 – (29,44,400 + 1,49,385 – 700,000) taken to profit and loss.

At the end of year 1, the ROU asset will be measured as under:

Year	Opening Balance (₹)	Depreciation (₹)	Closing Balance (₹)
1	29,44,400	5,88,880	23,55,520

12. Journal Entries

Books of Company P

Particulars	Debit (₹)	Credit (₹)
Investment in Company B Dr.	2,17,500	
To Equity Share Capital A/c (2,500 shares x ₹ 10)		25,000
To Securities Premium A/c (2,500 shares x ₹ 77)		1,92,500
(Being allotment of 25 shares each to 100 employees of B at fair value of ₹ 87 per share)		

Books of Company B

Particulars	Debit (₹)	Credit (₹)
Employee Benefit Expense A/c Dr.	2,17,500	
To Capital Contribution from Parent P		2,17,500
(Being issue of shares by Parent to Employees pursuant to Group Share-based Payment Plan)		

13. Computation of Goodwill / Capital reserve on consolidation as per Ind AS 103

Particulars	₹
Cost of investment:	
Share exchange (50,000 x 25)	12,50,000
Cash consideration	50,00,000
Contingent consideration	9,80,000
Consideration transferred at date of acquisition [A]	72,30,000
Fair value of non-controlling interest at date of acquisition [B] (1,00,000 x 35% x 12)	4,20,000
Total [C] = [A] + [B]	76,50,000

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Net assets acquired at date of acquisition [D]	(80,00,000)
Capital Reserve [D] – [C]	3,50,000

In a business combination, acquisition-related costs (including stamp duty) are expensed in the period in which such costs are incurred and are not included as part of the consideration transferred. Therefore, ₹ 1,50,000 incurred by Nafa Ltd. in relation to acquisition, will be ignored by Bima Ltd.

Journal entry at the date of acquisition by Bima Limited as per Ind AS 103:

	₹	₹
Identifiable net assets Dr.	80,00,000	
To Equity share capital (50,000 x 10)		5,00,000
To Securities Premium (50,000 x 15)		7,50,000
To Cash		50,00,000
To Provision for contingent consideration to Nafa Ltd.		9,80,000
To Non-controlling Interest		4,20,000
To Capital Reserve		3,50,000

14.

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 considered in 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

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		biological assets for sale or additional biological assets.
Development of living organisms such as cells, bacteria viruses	Analysis required	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. However, if the organisms are being developed for sale or use in dairy products, the activity will be considered as agricultural activity 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.
Purchase of 25 dogs for security purposes of the company's premises	No	Ind AS 41 is applied to account for the biological assets when they relate to agricultural activity. Guard dogs for security purposes do not qualify as agricultural activity, since they are not being kept for sale, or for conversion into agricultural produce or into additional biological assets. Hence, they are outside the scope of Ind AS 41.

15. ***1 April 20X1***

A financial guarantee contract is initially recognised at fair value. The fair value of the guarantee will be the present value of the difference between the net contractual cash flows required under the loan, and the net contractual cash flows that would have been required without the guarantee.

Particulars	**Year 1 (₹)**	**Year 2 (₹)**	**Year 3 (₹)**	**Total (₹)**
Cash flows based on interest rate of 11% (A)	1,10,000	1,10,000	1,10,000	3,30,000
Cash flows based on interest rate of 8% (B)	80,000	80,000	80,000	2,40,000
Interest rate differential (A-B)	30,000	30,000	30,000	90,000

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Discount factor @ 11%	0.901	0.812	0.731	
Interest rate differential discounted at 11%	27,030	24,360	21,930	73,320
Fair value of financial guarantee contract (at inception)				**73,320**

Journal Entry

Particulars		Debit (₹)	Credit (₹)
Investment in subsidiary	Dr.	73,320	
To Financial guarantee (liability)			73,320
(Being financial guarantee initially recorded)			

31 March 20X2

Subsequently at the end of the reporting period, financial guarantee is measured at the higher of:

- the amount of loss allowance; and
- the amount initially recognised less cumulative amortization, where appropriate.

At 31 March 20X2, there is 1% probability that Moon Limited may default on the loan in the next 12 months. If Moon Limited defaults on the loan, Sun Limited does not expect to recover any amount from Moon Limited. The 12-month expected credit losses are therefore ₹10,000 (₹10,00,000 x 1%).

The initial amount recognised less amortisation is ₹51,385 (₹73,320 + ₹8,065 (interest accrued based on EIR)) – ₹30,000 (benefit of the guarantee in year 1) Refer table below. The unwound amount is recognised as income in the books of Sun Limited, being the benefit derived by Moon Limited not defaulting on the loan during the period.

Year	Opening balance ₹	EIR @ 11%	Benefits provided ₹	Closing balance ₹
1	73,320	8,065	(30,000)	51,385
2	51,385	5,652	(30,000)	27,037
3	27,037	2,963*	(30,000)	-

* Difference is due to approximation

The carrying amount of the financial guarantee liability after amortisation is therefore ₹ 51,385, which is higher than the 12-month expected credit losses of ₹ 10,000. The liability is therefore adjusted to ₹ 51,385 (the higher of the two amounts) as follows:

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Particulars	Debit (₹)	Credit (₹)
Financial guarantee (liability) Dr.	21,935	
To Profit or loss		21,935
(Being financial guarantee subsequently adjusted)		

31 March 20X3

At 31 March 20X3, there is 3% probability that Moon Limited will default on the loan in the next 12 months. If Moon Limited defaults on the loan, Sun Limited does not expect to recover any amount from Moon Limited. The 12-month expected credit losses are therefore ₹ 30,000 (₹ 10,00,000 x 3%).

The initial amount recognised less accumulated amortisation is ₹ 27,037, which is lower than the 12-month expected credit losses (₹ 30,000). The liability is therefore adjusted to ₹ 30,000 (the higher of the two amounts) as follows:

Particulars	Debit (₹)	Credit (₹)
Financial guarantee (liability) Dr.	21,385*	
To Profit or loss (Note)		21,385
(Being financial guarantee subsequently adjusted)		

* The carrying amount at the end of 31 March 20X2 = ₹ 51,385 less 12-month expected credit losses of ₹ 30,000.

16. **(a)** As per paragraph 66(a) of Ind AS 1, an entity shall classify an asset as current when it expects to realise the asset, or intends to sell or consume it, in its normal operating cycle.

Paragraph 68 provides the guidance that current assets include assets (such as inventories and trade receivables) that are sold, consumed or realised as part of the normal operating cycle even when they are not expected to be realised within twelve months after the reporting period.

In accordance with above, the receivables that are considered a part of the normal operating cycle will be classified as current asset.

If the operating cycle exceeds twelve months, then additional disclosure as required by paragraph 61 of Ind AS 1 is required to be given in the notes.

(b) As discussed in point (a) above, advances to suppliers for goods and services would be classified in accordance with normal operating cycle if it is given in relation to the goods or services in which the entity normally deals. If the advances are considered a part the normal operating cycle, it would be classified as a current asset. If the operating cycle exceeds twelve months, then additional disclosure as required by paragraph 61 of Ind AS 1 is required to be given in the notes.

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(c) Classification of income tax receivables [other than deferred tax] will be driven by paragraph 66 (c) of Ind AS 1, i.e., based on the expectation of the entity to realise the asset. If the receivable is expected to be realised within twelve months after the reporting period, then it will be classified as current asset else non-current asset.

(d) Para 8 of Ind AS 16 states that items such as spare parts, stand-by equipment and servicing equipment are recognised in accordance with this Ind AS when they meet the definition of property, plant and equipment. Otherwise, such items are classified as inventory.

Accordingly, the insurance spares that are treated as an item of property, plant and equipment would normally be classified as non-current asset whereas insurance spares that are treated as inventory will be classified as current asset if the entity expects to consume it in its normal operating cycle.

17. Para 47 of Ind AS 21 requires that goodwill arose on business combination shall be expressed in the functional currency of the foreign operation and shall be translated at the closing rate in accordance with paragraphs 39 and 42.

In this case, the amount of goodwill will be as follows:

Net identifiable asset	Dr.	₹ 23 million	
Goodwill (bal. fig.)	Dr.	₹ 1.4 million	
To Bank (Purchase consideration)			₹ 17.5 million
To NCI (23 x 30%)			₹ 6.9 million

Thus, goodwill on reporting date in the books of Monsoon Limited would be

= 1.4 million EURO x ₹ 84 = ₹ 117.6 million.

18. Computation of Expected Return on Plan Assets

Particulars	₹
Return on ₹ 10,00,000 for 20X0-20X1 at 10.25% = ₹ 10,00,000 x 10.25%	1,02,500
Add: Return on ₹ 3,00,000 for 6 months at 10% Normal Rate = [3,00,000 (Inflow ₹ 4,90,000 less Payments ₹ 1,90,000) x 10% x 6/12)]	15,000
Expected Return on Plan Assets	**1,17,500**

Computation of Actual Return on Plan Assets

Particulars	₹
Fair Value of Plan Assets at the year-end – 31 March 20X1	15,00,000
Less: Fair Value of Plan Assets at the beginning – 1 April 20X0	(10,00,000)

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Less: Contributions received during the year 20X0-20X1	(4,90,000)
Add: Benefits paid during the year 20X0-20X1	1,90,000
Actual Return on Plan Assets	**2,00,000**

Computation of Net Actuarial Gain

Particulars	₹
Actual Return on Plan Assets	2,00,000
Less: Expected Return on Plan Assets	(1,17,500)
Actuarial Gain on Plan Assets	82,500
Less: Actuarial Loss on Defined Benefit Obligation (given)	(6,000)
Net Actuarial Gain to be recognized in 'Other Comprehensive Income'	**76,500**

19. As per Ind AS 36, the revised carrying amount of asset ASSOTA would be ₹6,50,000.

The tax base of asset ASSOTA is given as ₹8,00,000.

Carrying base of asset = ₹6,50,000

Tax base of asset = ₹8,00,000

Since tax base is greater than carrying base of asset, so deferred tax asset would be created on the temporary difference of ₹1,50,000 (₹8,00,000 – ₹6,50,000) at the given tax rate of 30%.

Hence, Deferred tax asset for the asset ASSOTA would be ₹1,50,000 x 30% = ₹45,000.

20. The goodwill on consolidation of Mission Ltd that is recognized in the consolidated balance sheet of Vision Ltd is ₹ 30 million (₹ 190 million – 80% x ₹ 200 million). This can only be reviewed for impairment as part of the cash generating units to which it relates. Since here the goodwill cannot be meaningfully allocated to the units, the impairment review is in two parts.

Units A and C have values in use that are more than their carrying values. However, the value in use of Unit B is less than its carrying amount. This means that the assets of unit B are impaired by ₹ 24 million (₹ 90 million – ₹ 66 million). This impairment loss will be charged to the statement of profit and loss.

Assets of Unit B will be written down on a pro-rata basis as shown in the table below:

(₹ in million)

Asset	**Impact on carrying value**		
	Existing	**Impairment**	**Revised**
Intangible assets	10	(4)	6
Property, plant and equipment	50	(20)	30

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Current assets	30	Nil*	30
Total	90	(24)	66

* The current assets are not impaired because they are expected to realize at least their carrying value when disposed of.

Following this review, the three units plus the goodwill are reviewed together i.e. treating Mission Limited as single cash generating Unit. The impact of this is shown in the following table, given that the recoverable amount of the business as a whole is ₹ 350 million: **(₹ in million)**

Component	**Impact of impairment review on carrying value**		
	Existing	**Impairment**	**Revised**
Goodwill (see note below)	37.50	(23.50)	14.00
Unit A	170.00	Nil	170.00
Unit B (revised)	66.00	Nil	66.00
Unit C	100.00	Nil	100.00
Total	373.50	(23.50)	350.00

Note: As per Appendix C of Ind AS 36, given that the subsidiary is 80% owned the goodwill must first be grossed up to reflect a notional 100% investment. Therefore, the goodwill will be grossed up to ₹ 37.50 million (₹ 30 million x 100/80).

The impairment loss of ₹ 23.50 million is all allocated to goodwill, leaving the carrying values of the individual units of the business as shown in the table immediately above.

The table shows that the notional goodwill that relates to a 100% interest is written down by ₹ 23.50 million to ₹ 14.00 million. However, in the consolidated financial statements the goodwill that is recognized is based on an 80% interest so the loss that is actually recognized is ₹ 18.80 million (₹ 23.50 million x 80%) and the closing consolidated goodwill figure is ₹ 11.20 million (₹ 14.00 million x 80%) or (₹ 30 million – ₹ 18.80 million).

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PAPER – 2: STRATEGIC FINANCIAL MANAGEMENT

QUESTIONS

Security Valuation

1. ABC Limited, just declared a dividend of ₹ 28.00 per share. Mr. A is planning to purchase the share of ABC Limited, anticipating increase in growth rate from 8% to 9%, which will continue for three years. He also expects the market price of this share to be ₹ 720.00 after three years.

   You are required to determine:

   (i) the maximum amount Mr. A should pay for shares, if he requires a rate of return of 13% per annum.

   (ii) the maximum price Mr. A will be willing to pay for share, if he is of the opinion that the 9% growth can be maintained indefinitely and require 13% rate of return per annum.

   (iii) the price of share at the end of three years, if 9% growth rate is achieved and assuming other conditions remaining same as in (ii) above.

   Note : Calculate rupee amount up to two decimal points and use PVF upto 3 decimal points.

2. KLM Limited has issued 90,000 equity shares of ₹ 10 each. KLM Limited's shares are currently selling at ₹ 72. The company has a plan to make a rights issue of one new equity share at a price of ₹ 48 for every four shares held.

   You are required to:

   (a) Calculate the theoretical post-rights price per share and analyse the change

   (b) Calculate the theoretical value of the right alone.

   (c) Suppose Mr. A who is holding 100 shares in KLM Ltd. is not interested in subscribing to the right issue, then advice what should he do.

Portfolio Management

3. Equity of ABC Ltd. (ABCL) is ₹ 500 Crores, its debt, is worth ₹ 290 Crores. Printer Division segments value is attributable to 64%, which has an Asset Beta (β_p) of 1.55, balance value is applied on Spares and Consumables Division, which has an Asset Beta (β_{sc}) of 1.40 ABCL Debt beta (β_D) is 0.28.

   You are required to calculate:

   (i) Equity Beta (β_E),

   (ii) Ascertain Equity Beta (β_E), if ABC Ltd. decides to change its Debt Equity position by raising further debt and buying back of equity to have its Debt to Equity Ratio at 1.50.

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Assume that the present Debt Beta (β_{D1}) is 0.45 and any further funds raised by way of Debt will have a Beta (β_{D2}) of 0.50.

(iii) Whether the new Equity Beta (β_E) justifies increase in the value of equity on account of leverage?

4. K Ltd. has invested in a portfolio of short-term equity investments. You are required to calculate the risk of K Ltd.'s short-term investment portfolio relative to that of the market from the information given below:

Investment	A	B	C	D
No. of shares	1,20,000	1,60,000	2,00,000	2,50,000
Market price per share (₹)	8.58	5.84	4.34	6.28
Beta	2.32	4.56	1.80	3.00
Expected Dividend Yield	9.50%	14.00%	7.50%	16.00%

The current market return is 20% and the risk free return is 10%.

Advise whether K Ltd. should change the composition of its portfolio. If yes, then how.

Note: Make calculations upto 4 decimal points.

Mutual Fund

5. The following particulars relating to S Fund Schemes:

Particulars			Value ₹ in Crores
1.	Investment in Shares (at cost)		
	a.	Pharmaceuticals companies	158
	b.	Construction Industries	62
	c.	Service Sector Companies	112
	d.	IT Companies	68
	e.	Real Estate Companies	20
2.	Investment in Bonds (Fixed Income)		
	a.	Listed Bonds (8000, 14% Bonds of ₹ 15,000 each)	24
	b.	Unlisted Bonds	14
3.	No. of Units outstanding (crores)		8.4
4.	Expenses Payable		7
5.	Cash and Cash equivalents		3
6.	Market expectations on listed bonds		8.842%

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The fund has incurred the following expenses:

Consultancy and Management fees ₹ 520 Lakhs

Office Expenses ₹ 180 Lakhs

Advertisement Expenses ₹ 48 Lakhs

Particulars relating to each sector are as follows:

Sector	Index on Purchase date	Index on Valuation date
Pharmaceutical companies	300	500
Construction Industries	275	490
Service Sector Companies	285	500
IT Companies	270	515
Real Estate Companies	265	440

Required:

(i) Calculate the Net Asset Value of the fund

(ii) Calculate the Net Asset Value per unit

(iii) Determine the Net return (Annualized), if the period of consideration is 4 years, and the fund has distributed ₹ 2 per unit per year as cash dividend during the same period.

Note: Calculate figure in ₹ Crore upto 3 decimal points.

Derivatives

6. The following data relate to R Ltd.'s share price:

Current price per share ₹ 1,900

6 months future's price/share ₹ 2050

Assuming it is possible to borrow money in the market for transactions in securities at 10% per annum,

(i) advise the justified theoretical price of a 6-months forward purchase; and

(ii) evaluate any arbitrage opportunity, if available.

7. The Following data relate to A Ltd.'s Portfolio:

Shares	X Ltd.	Y Ltd.	Z Ltd.
No. of Shares (lakh)	6	8	4
Price per share (₹)	1000	1500	500
Beta	1.50	1.30	1.70

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The CEO is of opinion that the portfolio is carrying a very high risk as compared to the market risk and hence interested to reduce the portfolio's systematic risk to 0.95. Treasury Manager has suggested two below mentioned alternative strategies:

(i) Dispose off a part of his existing portfolio to acquire risk free securities, or

(ii) Take appropriate position on Nifty Futures, currently trading at 8250 and each Nifty points multiplier is ₹ 210.

You are required to:

(a) Interpret the opinion of CEO, whether it is correct or not.

(b) Calculate the existing systematic risk of the portfolio,

(c) Advise the value of risk-free securities to be acquired,

(d) Advise the number of shares of each company to be disposed off,

(e) Advise the position to be taken in Nifty Futures and determine the number of Nifty contracts to be bought/sold; and

(f) Calculate the new systematic risk of portfolio if the company has taken position in Nifty Futures and there is 2% rise in Nifty.

Note: Make calculations in ₹ lakh and upto 2 decimal points.

Foreign Exchange Exposure and Risk Management

8. Doom Ltd. is an export business house. The company prepares invoice in customers' currency. Its debtors of US$ 48, 00,000 is due on April 1, 2020.

Market information as at January 1, 2020 is:

Exchange rates US$/INR		**Currency Futures US$/INR**	
Spot	0.014285	Contract size: ₹ 2,88,16,368	
1-month forward	0.014184	1-month	0.014178
3-months forward	0.013889	3-month	0.013881

	Initial Margin	**Interest rates in India**
1-Month	₹ 27,500	5.5%
3-Months	₹ 32,500	9%

On April 1, 2020 the spot rate US$/INR is 0.013894 and currency future rate is 0.013893.

Recommend as to which of the following methods would be most advantageous to Doom Ltd.

(i) Using forward contract

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(ii) Using currency futures

(iii) Not hedging the currency risk

Note: Round off calculation upto zero decimal points.

9. Telereal Trillium, a UK Company is in the process of negotiating an order amounting €5.5 million with a large German retailer on 6 month's credit. If successful, this will be first time for Telereal Trillium has exported goods into the highly competitive German Market. The Telereal Trillium is considering following 3 alternatives for managing the transaction risk before the order is finalized.

    (i) Mr. Grand, the Marketing head has suggested that in order to remove transaction risk completely Telereal Trillium should invoice the German firm in Sterling using the current €/£ average spot rate to calculate the invoice amount.

    (ii) Mr. John, CE is doubtful about Mr. Grand's proposal and suggested an alternative of invoicing the German firm in € and using a forward exchange contract to hedge the transaction risk.

    (iii) Ms. Royce, CFO is agreed with the proposal of Mr. John to invoice the German first in €, but she is of opinion that Telereal Trillium should use sufficient 6 month sterling future contracts (to the nearest whole number) to hedge the transaction risk.

    Following data is available

Spot Rate	€ 1.1980 - €1.1990/£
6 months forward points	0.60 – 0.55 Euro Cents.
6 month future contract is currently trading at	€ 1.1943/£
6 month future contract size is	£70,500
After 6 month Spot rate and future rate	€ 1.1873/£

    You are required to

    (a) Advise the alternative you consider to be most appropriate.

    (b) Interpret the proposal of Mr. Grand from non-financial point of view.

    Note: Calculate (to the nearest £) the £ receipt.

International Financial Management

10. Right Limited has proposed to expand its operations for which it requires funds of $ 30 million, net of issue expenses which amount to 4% of the issue size. It proposed to raise the funds though a GDR issue. It considers the following factors in pricing the issue:

    (i) The expected domestic market price of the share is ₹ 300 (Face Value of ₹ 10 each share)

    (ii) 4 shares underly each GDR

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(iii) Underlying shares are priced at 20% discount to the market price

(iv) Expected exchange rate is ₹ 70/$

You are required to compute the number of GDR's to be issued and cost of GDR to Right Limited, if 20% dividend is expected to be paid with a growth rate of 20%.

Interest Rate Risk Management

11. Espaces plc is consumer electronics wholesaler. The business of the firm is highly seasonal in nature. In 6 months of a year, firm has a huge cash deposits and especially near Christmas time and other 6 months firm cash crunch, leading to borrowing of money to cover up its exposures for running the business.

    It is expected that firm shall borrow a sum of £25 million for the entire period of slack season in about 3 months.

    The banker of the firm has given the following quotations for Forward Rate Agreement (FRA):

    Spot 5.50% - 5.75%

    3 × 6 FRA 5.59% - 5.82%

    3 × 9 FRA 5.64% - 5.94%

    3-month £50,000 future contract maturing in a period of 3 months is quoted at 94.15.

    You are required to:

    (a) Advise the position to be taken in Future Market by the firm to hedge its interest rate risk and demonstrate how 3 months Future contract shall be useful for the firm, if later interest rate turns out to be (i) 4.5% and (ii) 6.5%

    (b) Evaluate whether the interest cost to Espace plc shall be less had it adopted the route of FRA instead of Future Contract.

    Note:- Ignore the time value of money in settlement amount for future contract.

Corporate Valuation

12. Sun Ltd. recently made a profit of ₹ 200 crore and paid out ₹ 80 crore (slightly higher than the average paid in the industry to which it pertains). The average PE ratio of this industry is 9. The estimated beta of Sun Ltd. is 1.2. As per Balance Sheet of Sun Ltd., the shareholder's fund is ₹ 450 crore and number of shares is 10 crore. In case the company is liquidated, building would fetch ₹ 200 crore more than book value and stock would realize ₹ 50 crore less.

    The other data for the industry is as follows:

Projected Dividend Growth	4%
Risk Free Rate of Return	6%

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Market Rate of Return 11%

Calculate the valuation of Sun Ltd. using

(a) P/E Ratio

(b) Dividend Growth Model

(c) Book Value

(d) Net Realizable Value

Mergers, Acquisitions and Corporate Restructuring

13. ABC Ltd. is intending to acquire XYZ Ltd. by way of merger and the following information is available in respect of these companies:

	ABC Ltd.	XYZ Ltd.
Total Earnings (E) (in lakh)	₹ 1200	₹400
Number of outstanding shares (S) (in lakh)	400	200
Price earnings ratio (P/E)	8	7

(a) Determine the maximum exchange ratio acceptable to the shareholders of ABC Ltd., if the P/E ratio of the combined firm is expected to be 8?

(b) Determine the minimum exchange ratio acceptable to the shareholders XYZ Ltd., if the P/E ratio of the combined firm is expected to be 10?

Note: Make calculation in lakh multiples and compute ratio upto 4 decimal points.

Theoretical Questions

14. (a) Explain the traits that an organisation should have to make itself financially sustainable.

(b) Describe the salient features of Foreign Currency Convertible Bonds.

(c) Explain how an organization interested in making investment in foreign country can assess Country Risk and mitigate this risk.

15. (a) 'Venture Capital Financing is a unique way of financing Startup'. Discuss.

(b) Explain the Secondary Participants involved in the process of Securitization of Instruments.

(c) Explain how Cash flow-based approach of valuation is different from Income based approach and also explain briefly the steps involved in this approach.

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SUGGESTED ANSWERS

1. (i) Expected dividend for next 3 years.

Year 1 (D_1) ₹ 28.00 (1.09) = ₹ 30.52

Year 2 (D_2) ₹ 28.00 $(1.09)^2$ = ₹ 33.27

Year 3 (D_3) ₹ 28.00 $(1.09)^3$ = ₹ 36.26

Required rate of return = 13% (Ke)

Market price of share after 3 years = (P_3) = ₹ 720

The present value of share

$$P_0 = \frac{D_1}{(1+ke)} + \frac{D_2}{(1+ke)^2} + \frac{D_3}{(1+ke)^3} + \frac{P_3}{(1+ke)^3}$$

$$P_0 = \frac{30.52}{(1+0.13)} + \frac{33.27}{(1+0.13)^2} + \frac{36.26}{(1+0.13)^3} + \frac{720}{(1+0.13)^3}$$

P_0 = 30.52(0.885) + 33.27(0.783) +36.26(0.693) +720(0.693)

P_0 = 27.01 + 26.05 + 25.13 + 498.96

P_0 = ₹ 577.15

(ii) If growth rate 9% is achieved for indefinite period, then maximum price of share should Mr. A willing be to pay is

$$P_0 = \frac{D_1}{(ke-g)} = \frac{₹\ 30.52}{0.13\text{-}0.09} = \frac{₹\ 30.52}{0.04} = ₹\ 763$$

(iii) Assuming that conditions mentioned above remain same, the price expected after 3 years will be:

$$P_3 = \frac{D_4}{k_e - g} = \frac{D_3(1.09)}{0.13-0.09} = \frac{36.26 x 1.09}{0.04} = \frac{39.52}{0.04} = ₹\ 988$$

2. (a) Calculation of theoretical Post-rights (ex-right) price per share

$$\text{Ex-right value} = \left[\frac{MN+SR}{N+R}\right]$$

Where,

M = Market price,

N = Number of old shares for a right share

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S = Subscription price

R = Right share offer

$$= \left[\frac{₹72 \times 4 + ₹48 \times 1}{4+1}\right] = ₹\ 67.20$$

Thus, post right issue the price of share has reduced by ₹4.80 per share.

(b) Calculation of theoretical value of the rights alone:

= Ex-right price – Cost of rights share

= ₹ 67.20 – ₹ 48 = ₹ 19.20

Or

$$= \frac{₹\,67.20 - ₹48}{4} = ₹\ 4.80$$

(c) If Mr. A is not interested in subscribing to the right issue, he can renounce his right eligibility @ ₹ 19.20 per right and can earn a gain of ₹ 480.

3. (i) Equity Beta

To calculate Equity Beta first we shall calculate Weighted Average of Asset Beta as follows:

= 1.55 x 0.64 + 1.40 x 0.36

= 0.992 + 0.504 = 1.496

Now we shall compute Equity Beta using the following formula:

$$\beta_{Asset} = \beta_{Equity}\left[\frac{E}{E + D(1 - t)}\right] + \beta_{Debt}\left[\frac{D\,(1 - t)}{E + D(1 - t)}\right]$$

Accordingly,

$$1.496 = \beta_{Equity}\left[\frac{500}{500 + 290}\right] + \beta_{Debt}\left[\frac{290}{500+290}\right]$$

$$1.496 = \beta_{Equity}\left[\frac{500}{790}\right] + 0.28\left[\frac{290}{790}\right]$$

β_{Equity} = 2.20

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(ii) Equity Beta on change in Capital Structure

Amount of Debt to be raised:

Particulars	Value (in ₹ Crore)
Total Value of Firm (Equity ₹ 500 crore + Debt ₹ 290 crore)	790
Desired Debt Equity Ratio	1.50 : 1.00
Desired Debt Level = $\frac{\text{Total Value x Debt Ratio}}{\text{Debt Ratio} + \text{Equity Ratio}}$	474
Less: Value of Existing Debt	(290)
Value of Debt to be Raised	184

Equity after Repurchase = Total value of Firm – Desired Debt Value

= ₹ 790 Crore – ₹ 474 Crore

= ₹ 316 Crore

Weighted Average Beta of ABCL:

Source of Finance	Investment (in ₹ Crore)	Weight	Beta of the Division	Weighted Beta
Equity	316	0.4	$\beta_{(E = X)}$	0.4x
Debt – 1	290	0.367	0.45	0.165
Debt – 2	184	0.233	0.50	0.117
	790	**Weighted Average Beta**		**0.282 + (0.4x)**

β_{ABCL} = 0.282 + 0.4x

1.496 = 0.282 + 0.4x

0.4x = 1.496 – 0.282

X = 1.214/0.4 = 3.035

$\beta_{\text{New Equity}}$ = 3.035

(iii) Yes, it justifies the increase as it leads to increase in the Value of Equity due to increase in Beta.

4. (i) To determine whether K Ltd. should change composition of its portfolio first we should determine the Beta of the Portfolio and compare it with implicit Beta as justified by the Return on Portfolio.

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Calculation of Beta of Portfolio

Invest-ment	No. of shares	Market Price (₹)	Market Value	Dividend Yield	Dividend	Composition	β	Weighted β
A	1,20,000	8.58	10,29,600	9.50%	97,812	0.2339	2.32	0.5426
B	1,60,000	5.84	9,34,400	14.00%	1,30,816	0.2123	4.56	0.9681
C	2,00,000	4.34	8,68,000	7.50%	65,100	0.1972	1.80	0.3550
D	2,50,000	6.28	15,70,000	16.00%	2,51,200	0.3566	3.00	1.0698
			44,02,000		5,44,928	1.0000		2.9355

Return of the Portfolio $\frac{5,44,928}{44,02,000} = 0.1238$

Beta of Port Folio 2.9355

Market Risk implicit

0.1238 = 0.10 + β× (0.20 – 0.10)

Or, 0.10 β + 0.10 = 0.1238

$$\beta = \frac{0.1238 - 0.10}{0.10} = 0.238$$

Market β implicit is 0.238 while the portfolio β is 2.93. Thus, the portfolio is marginally risky compared to the market.

(ii) To decide whether K Ltd. should change the composition of its portfolio the dividend yield (given) should be compared with the Expected Return as per CAPM as follows:

Expected return as per CAPM is $R_f + (R_M - R_f)\,\beta$

Accordingly,

Expected Return for investment A	=	0.10 + (0.20 - 0.10) 2.32
	=	33.20%
Expected Return for investment B	=	0.10 + (0.20 - 0.10) 4.56
	=	55.60%
Expected Return for investment C	=	0.10 + (0.20 - 0.10) 1.80
	=	28%
For investment D, Rs	=	0.10 + (0.20 - 0.10) 3
	=	40%

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Comparing dividend yields with the expected returns of investment as per CAPM it can be observed that all investments are over-priced and they should be sold by the K Ltd. and acquire new securities.

5. (i) Calculation of NAV of the Fund

			(in ₹ Crore)
1.	Value of Shares		
	a. Pharmaceutical Companies	$158 \times \frac{500}{300}$	263.333
	b. Construction Companies	$62 \times \frac{490}{275}$	110.473
	c. Service Sector Companies	$112 \times \frac{500}{285}$	196.491
	d. IT Companies	$68 \times \frac{515}{270}$	129.704
	e. Real Estate Companies	$20 \times \frac{440}{265}$	33.208
2.	Investment in Bonds		
	a. Listed Bonds	$\frac{14}{8.842} \times 24$	38.00
	b. Unlisted Bonds		14.000
3.	Cash and Cash Equivalents		3.00
			788.209
	Less: Expense Payable		7.000
	NAV of the Fund		781.209

(ii) NAV of the Fund per Unit

NAV of the Fund	₹ 781.209 crore
Number of Units	8.40 crore
NAV Per Unit (₹ 781.209 crore/ 8.40 crore)	₹ 93.00

(iii) Net Return

Initial Cost Per Unit Investment in Shares	₹ 420 crore	

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Bonds	₹ 38 crore	₹ 458 crore
Number of Units		8.40 crore
Cost Per Unit		₹ 54.52
Return		
Capital Gain	(₹ 93.00 – ₹ 54.52)	₹ 38.48
Dividend	₹ 4x 2	₹ 8.00
		₹ 46.48
Annualised Return	$\frac{46.48}{54.52} \times \frac{1}{4}$	21.31%

6. (i) The justified theoretical price of a 6 months forward contract as per cost to carry model is as follows:

Theoretical minimum price = ₹ 1,900 + (₹ 1,900 x 10/100 x 6/12) = ₹ 1,995

(ii) Arbitrage Opportunity - Since current future price is ₹2050, yes there is an opportunity for carrying arbitrage profit. The arbitrageur can borrow money @ 10 % for 6 months and buy the shares at ₹ 1,900. At the same time he can sell the shares in the futures market at ₹ 2,050. On the expiry date 6 months later, he could deliver the share and collect ₹ 2,050 pay off ₹ 1,995 and record a risk –less profit of ₹ 55 (₹ 2,050 – ₹ 1,995).

7. (a) Yes, the apprehension of CEO is correct as the current portfolio is more riskier than market as the beta (Systematic Risk) of market portfolio is as computed as follows:

Shares	No. of shares (lakhs) (1)	Market Price of Per Share (2) (₹)	(1) × (2) (₹ lakhs)	% to total (w)	ß (x)	Wx
X Ltd.	6.00	1000.00	6000.00	0.30	1.50	0.45
Y Ltd.	8.00	1500.00	12000.00	0.60	1.30	0.78
Z Ltd.	4.00	500.00	2000.00	0.10	1.70	0.17
			20000.00	1.00		1.40

(b) Since the Beta of existing portfolio is 1.40, the systematic risk of the current portfolio is 1.40.

(c) Required Beta 0.95

Let the proportion of risk-free securities for target beta 0.95 = p

$$0.95 = 0 \times p + 1.40 (1 - p)$$

$$p = 0.32 \text{ i.e. } 32\%$$

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Shares to be disposed off to reduce beta (20000 × 32%) ₹ 6,400 lakh and Risk Free securities to be acquired for the same amount.

(d) Number of shares of each company to be disposed off

Shares	% to total (w)	Proportionate Amount (₹ lakhs)	Market Price Per Share (₹)	No. of Shares (Lakh)
X Ltd.	0.30	1920.00	1000.00	1.92
Y Ltd.	0.60	3840.00	1500.00	2.56
Z Ltd.	0.10	640.00	500.00	1.28

(e) Since, the company is in long position in cash market it shall take short position in Future Market.

Number of Nifty Contract to be sold

$$\frac{(1.40\text{-}0.95) \times 20000 \text{ lakh}}{8{,}250 \times 210} = 519 \text{ contracts}$$

(f) If there is 2% rises in Nifty there will be 2.80%(2%x1.40) rise for portfolio of shares

	₹ Lakh
Current Value of Portfolio of Shares	20000
Value of Portfolio after rise	20560
Mark-to-Market Margin paid (8250 × 0.020 × ₹ 210 × 519)	179.83
Value of the portfolio after rise of Nifty	20380.17
% change in value of portfolio (20380.17 – 20000)/ 20000	1.90%
% rise in the value of Nifty	2%
New Systematic Risk (Beta)	0.95

8. Receipts using a forward contract = $ 48,00,000/0.013889 = ₹ 34,55,97,235

Receipts using currency futures

The number of contracts needed is ($ 48,00, 000/0.013881)/ 28,816,368 = 12

Initial margin payable is 12 contracts x ₹ 32,500 = ₹ 3,90,000

On April 1, 2020 Close at 0.013893

Receipts = US$ 48,00,000/0.013894 = ₹ 34,54,72,866

Variation Margin

[(0.013893 – 0.013881) x 12 x 28,816,368]/0.013894

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OR (0.000012 x 12 x 28,816,368)/0.013894 = = 4149.5570/0.013894	₹ 2,98,658
Less: Interest Cost – ₹ 3,90,000 x 0.09 x 3/12	₹ 8,775
Net Receipts	₹ 34,57,62,749

Receipts under different methods of hedging

Forward contract	₹ 34,55,97,235
Future Contract	₹ 34,57,62,749
No Hedge (US$ 48,00,000/ 0.013894)	₹ 34,54,72,866

The most advantageous option would have been to hedge with futures as it is slightly higher than Forward Option but comparing to no hedge option it is better proposition.

9. (a) (i) Receipt under three proposals

(a) Proposal of Mr. Grand

Invoicing in £ will produce = $\frac{€5.5 \text{ million}}{1.1990}$ = £ 45, 87,156

(b) Proposal of Mr. John

Forward Rate= €1.1990 - 0.0055 = 1.1935

Using Forward Market hedge Sterling receipt would be $\frac{€5.5 \text{ million}}{1.1935}$ = £ 46,08,295

(c) Proposal of Ms. Royce

The equivalent sterling of the order placed based on future price (€1.1943)

= $\frac{€5.5 \text{ million}}{1.1943}$ = £ 46, 05,208 (rounded off)

Number of Contracts = $\frac{£46,05,208}{70,500}$ = 65 Contracts (to the nearest whole number)

Thus, € amount hedged by future contract will be = $65 \times £70,500$ = £45,82,500

Buy Future at	€1.1943
Sell Future at	€1.1873
	€0.0070

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Total loss on Future Contracts = $65 \times £70{,}500 \times €0.0070$ = €32,078

After 6 months

Amount Received	€55, 00,000
Less: Loss on Future Contracts	€ 32,078
	€ 54, 67,922

Sterling Receipts

On sale of € at spot = $\frac{€54,67,922}{1.1873}$ = £46, 05,342

Proposal of option (ii) is preferable because the option (i) & (iii) produces least receipts.

(b) Further, in case of proposal (i) there must be a doubt as to whether this would be acceptable to German firm as it is described as a competitive market and Telereal Trillium is moving into it first time.

10. Net Issue Size = \$30 million

Gross Issue = $\frac{\$30 \text{ million}}{0.96}$ = \$31.25 million

Issue Price per GDR in ₹ (300 x 4 x 80%)	₹ 960
Issue Price per GDR in \$ (₹ 960/ ₹ 70)	\$13.71
Dividend per GDR (D_1) (₹ 2 x 4)	₹ 8
Net Proceeds per GDR (₹ 960 x 0.96)	₹ 921.60

(a) Number of GDR to be issued

$$\frac{\$31.25 \text{ million}}{\$13.71} = 2.2794 \text{ million}$$

(b) Cost of GDR to Right Ltd.

$$k_e = \frac{8}{921.60} + 0.20 = 20.87\%$$

11. (a) (i) Since firm is a borrower it will like to off-set interest cost by profit on Future Contract. Accordingly, if interest rate rises it will gain hence it should sell interest rate futures.

$$\text{No. of Contracts} = \frac{\text{Amount of Borrowing}}{\text{Contract Size}} \times \frac{\text{Duration of Loan}}{3 \text{ months}}$$

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$$= \frac{£\ 25,000,000}{£\ 50,000} \times \frac{6}{3} = 1000 \text{ Contracts}$$

(ii) The final outcome in the given two scenarios shall be as follows:

	If the interest rate turns out to be 4.5%	**If the interest rate turns out to be 6.5%**
Future Course Action :		
Sell to open	94.15	94.15
Buy to close	95.50 (100 - 4.5)	93.50 (100 - 6.5)
Loss/ (Gain)	1.35%	(0.65%)
Cash Payment (Receipt) for Future Settlement	£ 50,000×1000× 1.35%×3/12 = £1,68,750	£ 50,000×1000×0.65%×3/12 = (£81,250)
Interest for 6 months on £50 million at actual rates	£ 25 million × 4.5% × ½ = £ 5,62,500	£ 25 million × 6.5% × ½ = £ 8,12,500
	£ 7,31,250	£ 7,31,250

Thus, the firm locked itself in interest rate $\frac{£\ 7,31,250}{£\ 25,000,000} \times 100 \times \frac{12}{6} = 5.85\%$

(b) No, the interest cost shall not be less for Espace plc had it taken the route of FRA, as the 3 x 9 FRA contract are available at 5.64% – 5.94% i.e. borrowing rate of 5.94%. Hence, the interest cost under this option shall be nearby by 5.94% which is more than interest rate under Future contract rate of 5.85%.

12. (a) ₹ 200 crore x 9 = ₹ 1800 crore

(b) K_e = 6% + 1.2 (11% - 6%) = 12%

$$= \frac{80 \text{ crore} \times 1.04}{0.12 - 0.04} = ₹\ 1040 \text{ crore}$$

(c) ₹ 450 crore

(d) ₹ 450 crore + ₹ 200 crore – ₹ 50 crore = ₹ 600 crore

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13. (a) Maximum exchange ratio acceptable to the shareholders of ABC Ltd.

Market Price of share of ABC Ltd. (₹ 3 x 8)	₹ 24
No. of Equity Shares	400 lakh
Market Capitalisation of ABC Ltd. (₹ 24 x 400 lakh)	₹ 9600 lakh
Combined Earnings (₹ 1200 + ₹ 400) lakh	₹ 1600 lakh
Combined Market Capitalisation (₹ 1600 lakh x 8)	₹ 12800 lakh
Market Capitalisation of ABC Ltd. (₹ 24x 400 lakh)	₹ 9600 lakh
Balance for XYZ Ltd.	₹ 3200 lakh

Let D be the no. of equity shares to be issued to XYZ Ltd. then,

$$\frac{₹\,3200\,\text{Lakh}}{\left(\frac{1600\text{ Lakh}}{D+400}\right)\times 8} = D$$

D = 133.333 lakh Shares

Exchange Ratio = 133.333 / 200 = 0.6666:1

(b) Minimum exchange ratio acceptable to the shareholders of XYZ Ltd.

Market Price of share of XYZ Ltd.	₹ 14.00
No. of Equity Shares	200 lakh
Market Capitalisation of XYZ Ltd. (₹ 14.00 x 200 lakh)	₹ 2800 lakh
Combined Earnings (₹ 1200 + ₹ 400) lakh	₹ 1600 lakh
Combined Market Capitalisation (₹ 1600 lakh x 10)	₹ 16000 lakh
Balance for ABC Ltd.	₹ 13200 lakh

Let D be the no. of equity shares to be issued to XYZ Ltd. then,

$$\frac{₹\,2800\,\text{lakh}}{\left(\frac{1600\text{ lakh}}{D+400}\right)\times 10} = D$$

D = 84.8485 lakh Shares

Exchange Ratio = 84.8485 / 200 = 0.4242:1

14. (a) To be financially sustainable, an organization must have following traits:

- have more than one source of income.
- have more than one way of generating income.

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- do strategic, action and financial planning regularly.
- have adequate financial systems.
- have a good public image.
- be clear about its values (value clarity); and
- have financial autonomy.

(b) The salient features of FCCBs are as follows:

1. FCCB is a bond denominated in a foreign currency issued by an Indian company which can be converted into shares of the Indian Company denominated in Indian Rupees.
2. Prior permission of the Department of Economic Affairs, Government of India, Ministry of Finance is required for their issue
3. There will be a domestic and a foreign custodian bank involved in the issue
4. FCCB shall be issued subject to all applicable Laws relating to issue of capital by a company.
5. Tax on FCCB shall be as per provisions of Indian Taxation Laws and Tax will be deducted at source.
6. Conversion of bond to FCCB will not give rise to any capital gains tax in India.

(c) Organisation can assess country risk

(1) By referring political ranking published by different business magazines.

(2) By evaluating country's macro-economic conditions.

(3) By analyzing the popularity of current government and assess their stability.

(4) By taking advises from the embassies of the home country in the host countries.

Further, following techniques can be used to mitigate this risk.

(i) Local sourcing of raw materials and labour.

(ii) Entering into joint ventures

(iii) Local financing

(iv) Prior negotiations

15. (a) Yes, Venture Capital Financing is unique manner of financing a Startup as it possesses the following characteristics:

(i) **Long time horizon**: The fund would invest with a long time horizon in mind. Minimum period of investment would be 3 years and maximum period can be 10 years.

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(ii) **Lack of liquidity**: When VC invests, it takes into account the liquidity factor. It assumes that there would be less liquidity on the equity it gets and accordingly it would be investing in that format. They adjust this liquidity premium against the price and required return.

(iii) **High Risk**: VC would not hesitate to take risk. It works on principle of high risk and high return. So, high risk would not eliminate the investment choice for a venture capital.

(iv) **Equity Participation**: Most of the time, VC would be investing in the form of equity of a company. This would help the VC participate in the management and help the company grow. Besides, a lot of board decisions can be supervised by the VC if they participate in the equity of a company.

(b) Secondary participants involved into the securitization process are as follows:

(i) Obligors: Actually they are the main source of the whole securitization process. They are the parties who owe money to the firm and are assets in the Balance Sheet of Originator. The amount due from the obligor is transferred to SPV and hence they form the basis of securitization process and their credit standing is of paramount importance in the whole process.

(ii) Rating Agency: Since the securitization is based on the pools of assets rather than the originators, the assets have to be assessed in terms of its credit quality and credit support available. Rating agency assesses the following:

- ❖ Strength of the Cash Flow.
- ❖ Mechanism to ensure timely payment of interest and principle repayment.
- ❖ Credit quality of securities.
- ❖ Liquidity support.
- ❖ Strength of legal framework.

Although rating agency is secondary to the process of securitization but it plays a vital role.

(iii) Receiving and Paying agent (RPA): Also, called Servicer or Administrator, it collects the payment due from obligor(s) and passes it to SPV. It also follow up with defaulting borrower and if required initiate appropriate legal action against them. Generally, an originator or its affiliates acts as servicer.

(iv) Agent or Trustee: Trustees are appointed to oversee that all parties to the deal perform in the true spirit of terms of agreement. Normally, it takes care of interest of investors who acquires the securities.

(v) Credit Enhancer: Since investors in securitized instruments are directly exposed to performance of the underlying and sometime may have limited or no recourse to the

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originator, they seek additional comfort in the form of credit enhancement. In other words, they require credit rating of issued securities which also empowers marketability of the securities.

Originator itself or a third party say a bank may provide this additional context called Credit Enhancer. While originator provides his comfort in the form of over collateralization or cash collateral, the third party provides it in form of letter of credit or surety bonds.

(vi) **Structurer:** It brings together the originator, investors, credit enhancers and other parties to the deal of securitization. Normally, these are investment bankers also called arranger of the deal. It ensures that deal meets all legal, regulatory, accounting and tax laws requirements.

(c) As opposed to the asset based and income based approaches, the cash flow approach takes into account the quantum of free cash that is available in future periods, and discounting the same appropriately to match to the flow's risk.

Simply speaking, if the present value arrived post application of the discount rate is more than the current cost of investment, the valuation of the enterprise is attractive to both stakeholders as well as externally interested parties (like stock analysts). It attempts to overcome the problem of over-reliance on historical data.

There are essentially five steps in performing DCF based valuation:

(i) Arriving at the 'Free Cash Flows'

(ii) Forecasting of future cash flows (also called projected future cash flows)

(iii) Determining the discount rate based on the cost of capital

(iv) Finding out the Terminal Value (TV) of the enterprise

(v) Finding out the present values of both the free cash flows and the TV, and interpretation of the results.

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PAPER – 3 : ADVANCED AUDITING AND PROFESSIONAL ETHICS

PART – I ACADEMIC UPDATE

(Legislative Amendments / Notifications / Circulars / Rules / Guidelines issued by Regulating Authority)

Students are required to refer updated Chapters applicable for May 2021 Examination on the below mentioned link:

Chapter. No.	Chapter Name	Link
Chapter 5	The Company Audit	**https://resource.cdn.icai.org/63102bos51055-cp5.pdf**
Chapter 11	Audit of Non-Banking Financial Companies	https://resource.cdn.icai.org/63103bos51055-cp11.pdf
Chapter 13	Audit of Public Sector Undertakings	https://resource.cdn.icai.org/63104bos51055-cp13.pdf
Chapter 14	Liabilities of Auditors	https://resource.cdn.icai.org/63105bos51055-cp14.pdf

Note: Students are also advised to refer RTP of Paper 1 Financial Reporting (for AS, Ind AS and other updates) and Paper 4 Part I -Corporate Laws (for academic updates relating to Company Law).

PART – II : QUESTIONS AND ANSWERS

QUESTIONS

PART A: MULTIPLE CHOICE QUESTIONS

Integrated Case Scenario 1.

M/s. Suresh & Co., a partnership firm, has been appointed, for the 7th consecutive year, as the statutory auditor of Alkis Ltd., an unlisted public company, for financial year 2020-21.

Mr. Suresh is the engagement partner for the audit assignment of Alkis Ltd. The engagement team, before starting the assignment, was made to read the policies and procedures designed to achieve desired quality control, with respect to the type of assignment being undertaken.

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Mr. Suresh, referred the engagement letter, signed with the management initially and was considering whether there was a requirement to send a new engagement letter, in light of following circumstances in the Company during F.Y. 2020-21:

- Two senior whole time directors of the Company have retired out of total five directors.
- 40% stake in the Company was held by promoters, which was reduced to 5%, by selling shares to general public.
- One more factory unit was set up in Gorakhpur, this year.
- Management has requested to cover 90% of the transactions with respect to each revenue line item, this time, instead of 80% of the transactions, as was set out in the audit plan, considering the materiality and other factors.

The following data is presented from the audited financial statements of Alkis Ltd., for the financial year 2019-2020:

(I) Paid up share capital - ₹ 8 crore;

(II) Turnover - ₹ 55 crore;

(III) Outstanding Borrowings - ₹ 14 crore;

(IV) Outstanding Public Deposits - ₹ 28 crore.

Mr. Suresh while preparing a report under section 143 of the Companies Act, 2013, made a statement with respect to the remuneration paid by the Alkis Ltd. to one of its directors, Mr. Mahesh, was in excess of the limit laid down under section 197 and also gave such other details as prescribed.

Mr. Suresh, for additional reporting purpose, while auditing with respect to compliance with CARO, 2016, observed the following, relevant to Para 3(vii) of CARO, 2016:

Statutory Dues	**Undisputed Amount (₹ in lakh)**	**Date Payable**	**Date Paid**
Income Tax Demand for A.Y. 2018-19	2	25th September, 2020	28th March, 2021
GST	1.5	3rd October, 2020	4th April, 2021
Customs Duty	0.80	20th September, 2020	10th April, 2021
Provident Fund	0.45	12th October, 2020	Not Paid till date

Also, a representation was made to GST Department for waiving a penalty of ₹ 1 lakh for late payment of GST demand.

The board of Alkis Ltd. declared interim dividend of ₹ 20 lakh on 20th May, 2021, to its 180 shareholders, out of surplus in the profit and loss account and such dividend amount was deposited in a separate bank with a branch of SBI.

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Dividend amounting to ₹ 1 lakh was not claimed by a shareholder, Mr. Rohit, till 19th June, 2021, and so the said amount of ₹ 1 lakh was transferred to Unpaid Dividend Account on 31st July, 2020.

On the basis of the abovementioned facts, you are required to answer the following MCQs:

Question No.: (1-5)

1. Which of the following option is correct with respect to Alkis Ltd.?

   (a) Alkis Ltd. needs to form an Audit Committee. Further, provisions relating to internal audit as well as rotation of auditors are applicable to Alkis Ltd.

   (b) Alkis Ltd. need not to form an Audit Committee. Further, provisions relating to internal audit is not applicable to Alkis Ltd. However, the provisions with respect to rotation of auditors are applicable to it.

   (c) Alkis Ltd. need not to form an Audit Committee. Further, provisions relating to rotation of auditors is not applicable to Alkis Ltd. However, the provisions with respect to internal audit are applicable to it.

   (d) Alkis Ltd. needs to form an Audit Committee. Provisions relating to internal audit is applicable to Alkis Ltd. However, the provisions with respect to rotation of auditors are not applicable to it.

2. Under which section of the auditor's report, Mr. Suresh needs to report with respect to the excess remuneration being paid to Mr. Mahesh?

   (a) Other Matters Paragraph.

   (b) Report on Other Legal and Regulatory Requirements.

   (c) Basis for Qualified Opinion.

   (d) Auditor's Responsibilities for the Audit of the Financial Statements.

3. What total amount of statutory dues needs to be reported by Mr. Suresh as per Para 3 of CARO?

   (a) ₹ 2.75 lakh.

   (b) ₹ 0.80 lakh.

   (c) ₹ 2.80 lakh.

   (d) ₹ 2.30 lakh.

4. How much amount of interest Alkis Ltd. would be liable to pay with respect to unpaid dividend amount?

   (a) ₹ 575.

   (b) ₹ 1,216.

   (c) ₹ 1,726.

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(d) ₹ 1,151.

5. By what date, the amount of interim dividend should have been deposited in the scheduled bank after being declared and also by what date, the unpaid or unclaimed dividend amount should have been transferred to Unpaid Dividend Account?

   (a) 25th May, 2021 and 24th June, 2021, respectively.

   (b) 25th May, 2021 and 26th June, 2021, respectively.

   (c) 30th May, 2021 and 19th July, 2021, respectively.

   (d) 27th May, 2021 and 26th June, 2021, respectively.

Integrated Case Scenario 2.

Victor & Co; a reputed Chartered Accountants firm is appointed as a Statutory auditor of Copper Man Creations Limited. The Company is into manufacturing of robotic products. The Company has advanced in all its endeavours by supplying million Copper suits. The Company has started the production of version 10 under its flagship and tags it as "Why to worry about a vehicle, when you have steel man". The main idea of the Company evolved after the promoter watched the Marvel series Iron Man. The product has been promoted by Robert Downy Jr as its product Brand Ambassador. The Company expects itself to manufacture these prototypes and expects the old prototypes to be obsolete due to the demand for version 10. Each version of the product has a separate department and promotes their sales under the single flagship of 'Copper Man' and thus, the managerial decision making is left to each version manager. You have assigned the 'Fixed Assets area' to Mr. Mamma Mia and he came out to you with the following points.

You need to answer the questions raised by him and go through the notes prepared to reach a reasonable conclusion over Property, Plant and Equipment FSLI (Financial Statement caption):

- The Company is holding the property in its name in Andaman & Nicobar while the land is registered in another person's name. The property is in dispute for the past 20 years. This is the major plant for the Company and it is the critical success factor for the client. The Company's 80% of the revenue is derived from this factory. When enquired with management, it would have to incur huge costs to relocate and the present advantageous conditions of the plant are very critical for the product manufactured. The Company has not conducted the physical verification of fixed assets since last 10 years but it has conducted the verification at other locations every year. When enquired with management, the Company explained it is highly impossible as the plant is 24*7 running and it couldn't be halted as the restart of operations will cost huge amounts and a month's time to get the Company back to current position.

- The audit team has come across a transaction where the Company is enjoying the property rent free. The audit team is of the opinion that the provisions of Benami transactions (Prohibition) Act, 1988 might apply in such scenario. This should be evaluated as part of CARO reporting. No other procedures in this regard need to be performed.

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- The Company follows the depreciation policy as per the Schedule II across all the factories even when the factory at Andaman & Nicobar is the only factory that runs 24*7. The useful life has been taken as it is mentioned in the Schedule II without modifications and the Company's future prospects are good, there are no impairment indications.

  On the basis of the abovementioned facts, you are required to choose the most appropriate answer for the following MCQs:

Question No.: (6-10)

6. The audit team has asked you about the Benami Transaction:

   (a) There is no requirement for the auditor to report the transaction as there are no proceedings initiated or pending against the Company under the Benami Transactions (Prohibition) Act, 1988.

   (b) As the auditor is not sure about the transaction and did not gather proper evidence, he can ignore the transaction. The auditor needs to obtain the representation letter and note the same as a follow up point for the next year audit.

   (c) The auditor needs to obtain the additional evidence about the transaction. He needs to assess the situation as to its impact over the financial statements along-with consideration of SA 250. Thus, he should consider the seriousness of matter and should assess the impact of the same over the report even though it is not required to be reported as part of CARO.

   (d) The auditor needs to report such matter as a part of CARO as it might turn into a potential issue under the Benami Transactions (Prohibition) Act, 1988.

7. The audit team has asked you about the implications of dispute on the Property, Plant and Equipment and whether any additional considerations/reporting are needed for the same:

   (a) The dispute on account of Property, Plant and Equipment is a civil case and one or the other Company may face such consequences. Thus, no additional audit procedures are required. However, auditor may report this fact under CARO.

   (b) The Property, Plant and Equipment is in dispute and the Company has to incur huge costs to identify the ideal plant with same conditions. Thus, this might amount to material uncertainty on the Company's side to continue as a going concern. Thus, he needs to report the same. However, he need not to report under CARO.

   (c) The Property, Plant and Equipment is under dispute, the auditor needs to report it as a key audit matter and request the Company to disclose it in notes to accounts in a single line that the property is in dispute. However, he need not to report under CARO.

   (d) The Company's major line of business is from the factory, which is under dispute, the audit team need to consider the status of the case and assess its implications over the going concern assumption of the Company if it loses its case. It should also report it as part of Sec 143(3) about the Company's financial transactions or matters which

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have an adverse impact on the functioning of the Company. It also needs to be reported as per CARO.

8. The audit team has asked you about the impairment of assets of the Company.

   (a) The Company has no impairment condition as the Company expects positive future cash flows from the assets and thus no need to assess the impairment.

   (b) The Company need to assess the impairment condition for the assets and need to assess the fair value of the assets used to generate income from the older versions. The auditee needs to take a decision based on the cash inflows of a Company as a whole for assessing the existence of the impairment condition.

   (c) There exists an impairment condition as the Company does not expect much business from the older versions due to anticipation of the huge demand of the new product. The Company need to assess the cash inflows at each version level.

   (d) The Company need not assess impairment of assets as this is very common in dynamic industries where the older versions become obsolete when the new one is introduced by the Company.

9. The audit team is sceptical about the Depreciation policy followed by the Company for the Andaman and Nicobar plant:

   (a) As the Company is following the Schedule II, the depreciation policy and the useful life is in line with the Companies Act, 2013. Hence the Company's depreciation policy is good to go.

   (b) As the Company is operating the plant 24*7, it will be eligible for extra shift depreciation as per Schedule II. For the assets where the condition of extra shift depreciation does not exist, the Company will be eligible to claim 50% extra depreciation as per schedule II.

   (c) As the Schedule III is applicable for the whole Company, the policy including useful life for the assets need to be same. There cannot be different useful lives for different assets across different locations. Thus, the depreciation policy of the Company is good to go.

   (d) As the Company is operating the plant 24*7, it will be referred to as continuous process plant. For the assets where the condition of extra shift depreciation does not exist, the Company will not be eligible to claim 100% extra depreciation as per Schedule II.

10. The audit team has raised a question over hiring an international brand ambassador for an Indian product and raised concerns over the contract of the same:

    (a) The auditor has no role to play in such scenario as the selection of brand ambassador and the running the business lies with the management. The auditor needs to go through the agreements entered, payments made etc.

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(b) The auditor needs to inform the Central Government as this might constitute a serious non-compliance of laws and regulations. The auditor should also assess the integrity of the management about the appointment of the foreign brand ambassador.

(c) As per the SA 250, "Consideration of laws and regulations in an audit of Financials Statements" the auditor needs to assess such matters as it is a legal violation to hire an international brand ambassador ignoring the local people. The audit team need to consider the same and report in its audit report about such implications.

(d) The auditor needs to qualify its audit report as the Company is against the "Vocal for Local" policy. The auditor needs to highlight the same in its audit report as this may lead to a serious brand deterioration of the Company.

Independent MCQs

11. Anant & Co. is the auditor of ST Insurance Company. The insurance company is also involved in re-insurance business and necessary provision for re-insurance premium has been made in the books of accounts. The insurance company is into a re-insurance whereby their contract relates to one particular risk and is expressed in the re-insurance policy. Each transaction is negotiated individually, and each party has a free choice i.e. for the insurance company to offer and the re-insurer to accept. What kind of a re-insurance business is the insurance company into?

(a) Facultative Re-insurance.

(b) Stop loss treaty re-insurance.

(c) Auto-fac re-insurance.

(d) Proportional treaty re-insurance.

12. Below is an extract from the list of supplier statements as at 31st March 2020 held by the Company and corresponding payables ledger balances at the same date along with some commentary on the noted differences:

Supplier	***Statement balance ₹'000***	***Payables ledger balance ₹'000***
Cete Company	80	60
Lice Company	185	115

The difference in the balance of **Cete Company** is due to an invoice which is under dispute due to defective goods which were returned on 30th March 2020. **Which of the following audit procedures should be carried out to confirm the balance owing to Cete Company?**

(I) Review post year-end credit notes for evidence of acceptance of return.

(II) Inspect pre year-end goods returned note in respect of the items sent back to the supplier.

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(III) Inspect post year-end cash book for evidence that the amount has been settled.

(a) 1, 2 and 3.

(b) 1 and 3 only.

(c) 1 and 2 only.

(d) 2 and 3 only.

PART B : DESCRIPTIVE QUESTIONS

Standards on Auditing, Statements and Guidance Notes

13. (a) Coccyx Ltd. supplies navy uniforms across the country. The Company has 3 warehouses at different locations throughout the India and 5 warehouses at the borders. The major stocks are generally supplied from the borders. Coccyx Ltd. appointed M/s OPAQE & Co. to conduct its audit for the financial year 2020-21. Mr. P, partner of M/s OPAQE & Co., attended all the physical inventory counting conducted throughout the India but could not attend the same at borders due to some unavoidable reason.

You are required to advise M/s OPAQE & Co.,

(I) How sufficient appropriate audit evidence regarding the existence and condition of inventory may be obtained?

(II) How is an auditor supposed to deal when attendance at physical inventory counting is impracticable?

(b) CA. Dev, a recently qualified practicing Chartered Accountant got his first internal audit assignment of a large manufacturing concern Growth Limited. As an internal auditor for Growth Limited, CA. Dev is required to verify whether there are adequate records for identification and value of Plant and Machinery, tools and dies and whether any of these items have become obsolescent and not in use. Draft a suitable audit programme for the above.

(c) (I) In an initial audit engagement, the auditor will have to satisfy about the sufficiency and appropriateness of 'Opening Balances' to ensure that they are free from misstatements, which may materially affect the current financial statements. Lay down the audit procedure, you will follow in cases (i) when the financial statements are audited for the preceding period by another auditor; and (ii) when financial statements are audited for the first time.

(II) If, after performing the procedure, you are not satisfied about the correctness of 'Opening Balances'; what approach you will adopt in drafting your audit report in two situations mentioned in (I) above?

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The Company Audit & Audit Report

14. Star Ltd. is a power generating company which uses coal as raw material for its power generating plant. The Company has been allotted coal blocks in the state of Jharkhand and Odisha. During the FY 2020-21, a scam regarding allotment of coal blocks was unveiled leading to a ban on the allotment of coal blocks to various companies including Star Ltd. This happened in the month of December 2020 and as such entire power generation process of Star Ltd, came to a halt in that month. As a result of such ban, and the resultant stoppage of the production process, many key managerial personnel of the company left the Company. There were delays in the of payment of wages and salaries and the banks from whom the Company had taken funds for project financing also decided not to extend further finance or to fund further working capital requirements of the Company.

    Further, when discussed with the management, the statutory auditor understood that the Company had no action plan to mitigate such circumstances. Further, all such circumstances were not reflected the financial statements of Star Ltd. What course of action should the statutory auditor of the Company consider in such situation?

Audit Committee and Corporate Governance

15. Mr. Ibrahim was appointed as statutory auditor of New Limited and Old Limited. Both the Companies were having their base in Chennai they had recently listed their shares on the Stock Exchange. For the financial year 2020-21, Mr. Ibrahim had signed limited review reports for each quarter, till the quarter ended 31st December 2020 for both the companies. Owing to his personal commitments and increased workload, he tendered his resignation to M/s New Limited on 30th January 2021 and asked the Company to appoint another auditor to issue audit report for the remaining quarter and the FY 2020-21 as a whole. But the management of the Company did not accept the same.

    Mr. Ibrahim continued to as act as auditor for M/s Old limited. During the 1st week of March 2021, Mrs. W (wife of Mr. Ibrahim) had borrowed a sum of ₹ 6 lakh from the Company for her personal use. Having come to know about this, Mr. Ibrahim immediately informed the management that he had been disqualified to act as auditor and told them that he won 't issue audit report for last quarter. But management of the Company argued that it's the legal responsibility of Mr. Ibrahim to do the same.

    Whether contention of management of New Limited and Old Limited is justified in asking Mr. Ibrahim to issue audit report for the last quarter and the FY 2020-21 as a whole, despite his resignation? Discuss.

Audit of Banks & Insurance Company

16. (a) You are auditing a small bank branch with staff strength of the manager, cashier and three other staff Peter, Prem and Pran. Among allocation of work for other areas, Peter who is a peon also opens all the mail and forwards it to the concerned person. He does not have a signature book so as to check the signatures on important

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communications. Prem has possession of all bank forms (e.g. Cheque books, demand draft/pay order books, travelers' cheques, foreign currency cards etc.). He maintains a record meticulously which you have test checked also. However, no one among staff regularly checks that. You are informed that being a small branch with shortage of manpower, it is not possible to always check the work and records. Give your comments.

(b) As at 31st March 2020 while auditing Universe Insurance Ltd, you observed that a policy has been issued on 27th March 2020 for fire risk favouring one of the leading corporate houses in the country without the actual receipt of premium and it was reflected as premium receivable. The Company maintained that it is a usual practice in respect of big customers and the money was collected on 7th April, 2020. You further noticed that there was a fire accident in the premises of the insured on 31st March 2020 and a claim was lodged for the same. The insurance company also made a provision for claim. Please respond.

Audit under Fiscal Laws

17. (a) Arihant Pvt Ltd is engaged in the business of providing corporate/professional training programs. It has an annual turnover of INR 74 crore. The Company is subject to tax audit for which the work has been started by the tax auditor. For the financial year ending 31 March 2021, the Company applied for GST registration for 5 new locations for which registration certificates have not yet been received by the Company. However, the registration number is available on the portal of relevant authority which can be verified by checking the details of the Company. In this case what should be the audit procedures to verify this registration number?

(b) Mr. Rohan, made an outward supply of ₹ 4.00 lakh to M/s. Park Enterprises on 30th April, 2020 on a credit period of 15 days. However, M/s Park Enterprises made the payment to Mr. Rohan after 45 days along with interest for 30 days delayed payment @ 12%. As such, Mr. Rohan received total payment of ₹ 4,04,000/- along with interest. However, while filing Form GSTR-3B/ Form GSTR-1, Mr. Rohan declared his outward supplies at ₹ 4.00 lakh. Even while filing Form GSTR-9, Mr. Rohan did not discharge his tax liability. As a GST auditor in Form GSTR-9C, what action is recommended by the auditors. Comment.

Internal Audit, Management Audit and Operational Audit

18. M/s Raka & Co., Chartered Accountants have been approached by Abhinandan Ltd., a company engaged in iron and steel manufacturing industry. The Company has been facing following operational issues:

(a) Penal interest for delayed payments to the overseas vendors despite having enough cash flows; and

(b) Despite having regular production and enough inventory, delays in shipping the final goods to the customers leading to its deteriorating vendor rating.

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As a partner of M/s Raka & Co., through detailed discussion with the Senior Manager of Abhinandan Ltd., you have concluded that all these delays are because of long decision-making cycles in the Company. As a consultant to the Company, would you recommend Management Audit or Operational Audit?

Professional Ethics

19. Comment on the following with reference to the Chartered Accountants Act, 1949 and schedules thereto:

    (a) C.A. Ajitnath is Special Executive Magistrate. He also took over as the Executive Chairman of Software Company on 1.4.2020. He is also a leading income tax practitioner and consultant for derivative products. He resides in Chennai near to the ION commodity stock exchange and does trading in commodity derivatives. Every day, he invests nearly 40% of his time to settle the commodity transactions. He has not taken any permission for becoming Special Executive Magistrate. However, he has got special permission of Council of ICAI for becoming Executive Chairman. Is C.A. Ajitnath liable for professional misconduct?

    (b) CA. Sambhav, the auditor of Mahvir Pvt. Ltd. has delegated following works to his articles and staff:

    ❖ Raising of bills and issuing acknowledgements for money receipts.

    ❖ Initiating and stamping of vouchers and of schedules prepared for the purpose of audit.

    ❖ Issuing acknowledgements for records produced.

    ❖ Signing financial statements of the company.

    Is this correct as per the Professional Ethics and ICAI's guidelines and pronouncements?

20. Write a short note on the following:

    (a) Technical, Ethical and Professional Standards as per Statement on Peer Review.

    (b) Important issues to be kept in mind by the investigator while preparing his report.

    (c) Direction by Tribunal in case auditor acted in a fraudulent manner.

    (d) Differences between Division II (Ind- AS- Other than NBFCs) and Division III (Ind-AS- NBFCs) of Schedule III.

    (e) Technology based /Digital Forensics Techniques.

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SUGGESTED ANSWERS

PART A : ANSWERS TO MULTIPLE QUESTIONS

1. (c)

2. (b)

3. (b)

4. (d)

5. (b)

6. (c)

7. (d)

8. (c)

9. (d)

10. (a)

11. (a)

12. (c)

PART B

13. (a) (I) Special Consideration with Regard to Inventory: As per SA 501 "Audit Evidence- Specific Considerations for Selected Items", when inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by:

(1) Attendance at physical inventory counting, unless impracticable, to:

(i) Evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting;

(ii) Observe the performance of management's count procedures;

(iii) Inspect the inventory; and

(iv) Perform test counts; and

(2) Performing audit procedures over the entity's final inventory records to determine whether they accurately reflect actual inventory count results.

(II) Attendance at Physical Inventory Counting Not Practicable: In some cases, attendance at physical inventory counting may be impracticable. This may be due to factors such as the nature and location of the inventory, for example, where inventory is held in a location that may pose threats to the safety of the

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auditor. The matter of general inconvenience to the auditor, however, is not sufficient to support a decision by the auditor that attendance is impracticable. Further, as explained in SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive.

Further, where attendance is impracticable, alternative audit procedures, for example, inspection of documentation of the subsequent sale of specific inventory items acquired or purchased prior to the physical inventory counting, may provide sufficient appropriate audit evidence about the existence and condition of inventory.

In some cases, though, it may not be possible to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by performing alternative audit procedures. In such cases, SA 705 on Modifications to the Opinion in the Independent Auditor's Report, requires the auditor to modify the opinion in the auditor's report as a result of the scope limitation.

(b) The Internal Audit Programme in connection with Plant and Machinery and Tools and dies may be on the following lines:

(i) **Internal Control Aspects:** The following may be incorporated in the audit programme to check the internal control aspects-

(a) Maintaining separate register for hired assets, leased asset and jointly owned assets.

(b) Maintaining register of fixed asset and reconciling to physical inspection of fixed asset and to nominal ledger.

(c) All movements of assets are accurately recorded.

(d) Authorisation be obtained for –

(1) a declaring a fixed asset scrapped.

(2) selling a fixed asset.

(e) Check whether additions to fixed asset register are verified and checked by authorised person.

(f) Proper recording of all additions and disposal.

(g) Examining procedure for the purchase of new fixed assets, including written authority, work order, voucher and other relevant evidence.

(h) Regular review of adequate security arrangements.

(i) Periodic inspection of assets is done or not.

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(j) Regular review of insurance cover requirements over fixed assets.

(ii) **Assets Register:** To review the registers and records of plant, machinery, etc. showing clearly the date of purchase of assets, cost price, location, depreciation charged, etc.

(iii) **Cost Report and Journal Register:** To review the cost relating to each plant and machinery and to verify items which have been capitalised.

(iv) **Code Register:** To see that each item of plant and machinery has been given a distinct code number to facilitate identification and verify the maintenance of Code Register.

(v) **Physical Verification:** To see physical verification has been conducted at frequent intervals.

(vi) **Movement Register:** To verify (a) whether Movement Register for movable equipments and (b) log books in case of vehicles, etc. are being maintained properly.

(vii) **Assets Disposal Register:** To review whether assets have been disposed off after proper technical and financial advice and sales/disposal/retirement, etc. of these assets are governed by authorisation, sales memos or other appropriate documents.

(viii) **Spare Parts Register:** To examine the maintenance of a separate register of tools, spare parts for each plant and machinery.

(ix) **Review of Maintenance:** To scrutinise the programme for an actual periodical servicing and overhauling of machines and to examine the extent of utilisation of maintenance department services.

(x) **Review of Obsolescence:** To scrutinise whether expert's opinion have been obtained from time to time to ensure purchase of technically most useful efficient and advanced machinery after a thorough study.

(xi) **Review of R&D:** To review R&D activity and ascertain the extent of its relevance to the operations of the organisation, maintenance of machinery efficiency and prevention of early obsolescence.

(c) (I) (i) Financial Statements Audited by another Auditor – Audit Procedure: If the prior period's financial statements were audited by a predecessor auditor, the auditor may be able to obtain sufficient appropriate audit evidence regarding the opening balances by perusing the copies of the audited financial statements including the other relevant documents relating to the prior period financial statements such as supporting schedules to the audited financial statements. Ordinarily, the current auditor can place reliance on the closing balances contained in the financial statements for the preceding period, except when during the performance

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of audit procedures for the current period the possibility of misstatements in opening balances is indicated.

(ii) **Audit of Financial Statements for the First Time – Audit Procedure:** When the audit of financial statements is being conducted for the first time, the auditor has to perform auditing procedures to obtain sufficient appropriate audit evidence. Since opening balances represent effect of transaction and events of the preceding period and accounting policies applied in the preceding period, the auditor need to obtain evidence having regard to nature of opening balances, materiality of the opening balances and accounting policies. Since it will not be possible for auditor to perform certain procedures, e.g., observing physical verification of inventories, etc. the auditor may obtain confirmation, etc. and perform suitable procedures in respect of fixed assets, investments, etc. The auditor can also obtain management representation with regards to the opening balances.

(II) **Drafting Audit Report:** If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall express a qualified opinion or a disclaimer of opinion, as appropriate. Further, If the auditor concludes that the opening balances contain a misstatement that materially affects the current period's financial statements, and the effect of the misstatement is not properly accounted for or not adequately presented or disclosed, the auditor shall express a qualified opinion or an adverse opinion.

14. SA 570- "Going Concern" deals with the auditor's responsibilities in the audit of financial statements relating to going concern and the implications for the auditor's report.

The auditor's responsibilities are to obtain sufficient appropriate audit evidence regarding, and conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements, and to conclude, based on the audit evidence obtained, whether a material uncertainty exists about the entity's ability to continue as a going concern.

When the use of going concern basis of accounting is inappropriate i.e., if the financial statements have been prepared using the going concern basis of accounting but, in the auditor's judgment, management's use of the going concern basis of accounting in the preparation of the financial statements is inappropriate, the auditor shall express an adverse opinion.

Also, when adequate disclosure of a material uncertainty is not made in the financial statements the auditor shall express a qualified opinion or adverse opinion, as appropriate, in accordance with SA 705 (Revised); and in the Basis for Qualified (Adverse) Opinion section of the auditor's report, state that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter.

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In the present case, the following circumstances indicate the inability of Star Ltd. to continue as a going concern:

- Ban on the allotment of coal blocks
- Halt in power generation
- Key Managerial Personnel leaving the Company.
- Banks decided not to extend further finance and not to fund the working capital requirements of the Company.
- Non availability of sound action plan to mitigate such circumstances.

Therefore, considering the above factors it is clear that the going concern basis is inappropriate for the Company. Further, such circumstances are not reflected in the financial statements of the Company. As such, the statutory auditor of Star Ltd. should:

(1) Express an adverse opinion in accordance with SA 705 (Revised) and

(2) In the Basis of Opinion paragraph of the auditor's report, the statutory auditor should state that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter.

15. In the given scenario, Mr. Ibrahim was appointed as statutory auditor of two listed entities i.e., New Limited and Old Limited. For the financial year 2020-21, Mr. Ibrahim had signed limited review reports for first three quarter i.e., till the quarter ended 31st December 2020 for both the companies. Owing to his personal commitments and increased workload, he resigned from New Limited and asked the Company to appoint another auditor to issue audit report for the remaining quarter and audit report for the FY 2020-21.

Further, Mr. Ibrahim immediately informed the management of Old Limited that he had been disqualified to act as auditor and told them that he won't issue audit report for last quarter as Mrs. W (wife of Mr. Ibrahim) had borrowed a sum of ₹ 6 lakh from the Company for her personal use.

As per SEBI LODR Regulations, if the auditor has signed the limited review/ audit report for the first three quarters of a financial year, then the auditor shall, before such resignation, issue the limited review/ audit report for the last quarter of such financial year as well as the audit report for such financial year. This provision will not apply if the auditor is disqualified due to Section 141 of the Companies Act, 2013.

Thus, in the given situation, in view of above conditions to be complied with upon resignation of the statutory auditor of a listed entity/material subsidiary with respect to limited review / audit report as per SEBI LODR Regulations, Mr. Ibrahim is required to issue the audit report for the last quarter and audit report for the year 2020-21 for New Limited as he has issued audit report for the first three quarters whereas Mr. Ibrahim is not

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required to issue the audit report for remaining quarter and audit report for the year 2020-21 as a whole for Old Limited as he is disqualified under section 141 of Companies Act.

Accordingly, contention of Management of New Limited is correct and tenable for issuing the audit report for remaining quarter and audit report for financial year 2020-21 however, contention of management of Old Limited is not correct regarding the legal responsibility of Mr. Ibrahim to issue audit report for remaining quarter and for the whole year.

16. (a) Banks are required to implement and maintain a system of internal controls for mitigating risks, maintain good governance and to meet the regulatory requirements. Given below are examples of internal controls that are violated in the given situation:

In the instant case, Peter who is a peon opens all the mail and forwards it to the concerned person. Further, he does not have a signature book so as to check the signatures on important communications is not in accordance with implementation and maintenance of general internal control. As the mail should be opened by a responsible officer. Signatures on all the letters and advices received from other branches of the bank or its correspondence should be checked by an officer with the signature book.

All bank forms (e.g. Cheque books, demand draft/pay order books, travelers' cheques, foreign currency cards etc.) should be kept in the possession of an officer, and another responsible officer should verify the issuance and stock of such stationery. In the given case, Prem has possession of all bank forms (e.g. cheque books, demand draft/pay order books, travelers' cheques, foreign currency cards etc.). He maintains a record meticulously which were also verified on test check basis.

Further, contention of bank that being a small branch with shortage of manpower they are not able to check the work and records on regular basis, is not tenable as such lapses in internal control pose risk of fraud.

The auditor should report the same in his report accordingly.

(b) No risk can be assumed by the insurer unless the premium is received. According to section 64VB of the Insurance Act, 1938, no insurer should assume any risk in India in respect of any insurance business on which premium is ordinarily payable in India unless and until the premium payable is received or is guaranteed to be paid by such person in such manner and within such time, as may be prescribed, or unless and until deposit of such amount, as may be prescribed, is made in advance in the prescribed manner. The premium receipt of insurance companies carrying on general insurance business normally arise out of three sources, viz., premium received from direct business, premium received from reinsurance business and the share of co-insurance premium.

In view of the above, the insurance company is not liable to pay the claim and hence no provision for claim is required.

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17. (a) Clause (4) (Details as to Indirect Tax Registration) of Part A of Form No. 3CD generally requires the auditor to ensure whether the assessee is liable to pay indirect tax like excise duty, service tax, sales tax, goods and service tax, custom duty, etc. If yes, please furnish the registration number or GST number or any other identification number allotted for the same. Thus, the auditor is primarily required to furnish the details of registration numbers as provided to him by the assessee. The reporting is required to be done in the manner or format specified by the e-filing utility in this context.

In the given situation, Arihant Pvt Ltd is engaged in the business of providing corporate/professional training programs. The Company is subject to tax audit. For the financial year ending 31 March 2021, the Company applied for GST registration for 5 new locations for which registration certificates have not yet been received by the Company. However, the registration number is available on the portal of relevant authority.

In the instant case, the tax auditor of Arihant Private Limited should verify the registration number for the locations for which registration certificates have not been received from online portal of the relevant authority.

The auditor should also ensure that the details furnished while checking the registration number pertains to the company only. If the company has filed any returns for these locations, the auditor should enquire for the same from the management and should check those returns to verify the correctness of the registration numbers. In addition, the auditor should also obtain specific representation in respect of this point from the management.

(b) In terms of section 15(2)(d) while computing value of taxable supply the transaction value shall include interest or late fee or penalty for delayed payment of any consideration for any supply. Since, Mr. Rohan did not pay tax on interest component, he made violation of valuation provisions. Mr. John was having option to discharge such liability at the time of filing of Form GSTR-9, which he did not avail. Therefore, the GST auditor may recommend him to discharge such liability at the time of making reconciliation statement in Form GSTR-9C.

18. A comparison between the Management Audit & the Operational Audit is as follows:

Management audit is concerned with the "Quality of managing", whereas operational audit focuses on the "Quality of operations".

Management audit is the "Audit of management" while the operational audit is the "Audit for the management". The focus of Management Audit is on "Quality of Decision Making" rather than the effectiveness or efficiency of operations.

The basic difference between the two audits, then, is not in method, but in the level of appraisal. In a management audit, the auditor is to make his tests to the level of top management, its formulation of objectives, plans and policies and its decision making. It is

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not that he just verifies the operations of control and procedures and fulfilment of plans in conformity with the prescribed policies.

Since, the delays in payments and consequent penal interest payments and the delays in shipping and the consequent deteriorating vendor ratings are happening because of the delays in decision-making process of the management of Abhinandan Ltd. Therefore, it appears that this is not just an internal control or operational issue but an issue of management process.

Therefore, Management Audit would be recommended in this case.

19. (a) Engaging into a Business: As per Clause (11) of Part I of First Schedule of Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he engages in any business or occupation other than the profession of Chartered Accountant unless permitted by the Council so to engage.

However, the Council has granted general permission to the members to engage in certain specific occupation. In respect of all other occupations specific permission of the Institute is necessary.

In this case, C.A. Ajitnath is Special Executive Magistrate, engaged in the occupation of trading in commodity derivatives and also took over as the Executive Chairman on 01.04.2020.

In this context, it may be noted that the Special Executive Magistrate which is generally permitted for Members of the Institute in practice, further specific permission is required for holding the position of Executive Chairman and getting engaged in the occupation of trading in commodity derivatives.

In the given situation, C.A. Ajitnath is acting as Special Executive Magistrate which is generally permitted for Members of the Institute in practice. Further, He is engaged in the occupation of trading in commodity derivatives which is not covered under the general permission. He also took over as the Executive Chairman for which specific permission is required. CA. Ajitnath got the permission for the same from the Council of ICAI.

Conclusion: Hence, CA. Ajitnath is not guilty for acting as Special Executive Magistrate as it is covered under the general permission. He is also not guilty for holding the position of Executive Chairman after getting specific permission of the Institute.

However, he is guilty of professional misconduct under Clause (11) of Part I of First Schedule of Chartered Accountants Act, 1949 for getting engaged in the occupation of trading in commodity derivatives which is not covered under the general permission.

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(b) As per Clause (12) of Part I of the First Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he allows a person not being a member of the institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, any balance sheet, profit and loss account, report or financial statements.

The Council has clarified that the power to sign routine documents on which a professional opinion or authentication is not required to be expressed may be delegated in the following instances and such delegation will not attract provisions of this clause:

(i) Issue of audit queries during the course of audit.

(ii) Asking for information or issue of questionnaire.

(iii) Letter forwarding draft observations/financial statements.

(iv) Initiating and stamping of vouchers and of schedules prepared for the purpose of audit.

(v) Acknowledging and carrying on routine correspondence with clients.

(vi) Issue of memorandum of cash verification and other physical verification or recording the results thereof in the books of the clients.

(vii) Issuing acknowledgements for records produced. Raising of bills and issuing acknowledgements for money receipts.

(ix) Attending to routine matters in tax practice, subject to provisions of Section 288 of Income Tax Act.

(x) Any other matter incidental to the office administration and routine work involved in practice of accountancy.

In the instant case, CA. Sambhav, the auditor of Mahvir Pvt. Ltd. has delegated certain task to his articles and staff such as raising of bills and issuing acknowledgements for money receipts, initiating and stamping of vouchers and of schedules prepared for the purpose of audit and issuing acknowledgements for records produced and signing financial statements of the company.

Therefore, CA. Sambhav is correct in allowing first three tasks i.e., raising of bills and issuing acknowledgements for money receipts, initiating and stamping of vouchers and of schedules prepared for the purpose of audit.

However, if the person signing the financial statements on his behalf is not a member of the institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, CA. Sambhav is not right in delegating signing of financial statements to his staff.

Conclusion: In view of this, CA. Sambhav would be guilty of professional misconduct for allowing the person signing the financial statements on his behalf to his articles

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and staff under Clause 12 of Part 1 of First Schedule of the Chartered Accountants Act, 1949.

20. (a) As per the Statement on Peer Review, Technical, Professional and Ethical Standards means:

(i) Accounting Standards issued by ICAI that are applicable for entities other than companies under the Companies Act, 2013;

(ii) Accounting Standards prescribed under section 133 of the Companies Act; 2013 by the Central Government based on the recommendation of ICAI and in consultation with the National Financial Reporting Authority (NFRA) and notified as Accounting Standards Rules 2006, as amended from to time;

(iii) Indian Accounting Standards prescribed under section 133 of the Companies Act 2013 by the Central Government based on the recommendation of ICAI and in consultation with NFRA and notified as Companies (Indian Accounting Standards) Rules, 2015, as amended from time to time;

(iv) Standards :

Standards issued by the Institute of Chartered Accountants of India including-
(a) Engagement standards (b) Statements (c) Guidance notes (d) Standards on Internal Audit. (e) Guidelines/ Notifications / Directions / Announcements / Pronouncements / Professional Standards issued from time to time by the Council or any of its Committees.

(v) Framework for the preparation and presentation of financial statements, Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services and Framework for Assurance engagements;

(vi) Provisions of the relevant statutes and / or rules or regulations which are applicable in the context of the specific engagements being reviewed including instructions, guidelines, notifications, directions issued by regulatory bodies as covered in the scope of assurance engagements.

(b) The important issues to be kept in mind by the investigator while preparing his report are as follows:

(i) The report should not contain anything which is not relevant either to highlight the nature of the investigation or the final outcome thereof.

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(ii) Every word or expression used should be properly considered so that the possibility of arriving at a different meaning or interpretation other than the one intended by the investigator can be minimized.

(iii) Relevant facts and conclusions should be properly linked with evidence.

(iv) Bases and assumptions made should be explicitly stated. Reasonableness of the bases and assumptions made should be well examined and care should be taken to see that none of the bases and assumptions can be considered to be in conflict with the objective of the investigation. For example, in an investigation into over-stocking of raw materials, inventories and spares etc. it should not be assumed that the ordering levels indicated on bin cards provide fair guidance about acquisition of further materials. Also, since investigation is a fact-finding assignment, assumptions should be made only when it is unavoidably necessary.

(v) The report should clearly spell out the nature and objective of the assignment accepted its scope and limitations, if any.

(vi) The report should be made in paragraph form with headings for the paragraphs. Any detailed data and figures supporting any finding may be given in Annexures.

(vii) The report should also state restrictions or limitations, if any, imposed on the instructions given by the client. Preferably the reasons for placing such restrictions and their impact on the final result should also be stated.

(viii) The opinion of the investigator should appear in the final paragraph of the report.

(c) Direction by Tribunal in case auditor acted in a fraudulent manner: As per sub-section (5) of the section 140, the Tribunal either *suo motu* or on an application made to it by the Central Government or by any person concerned, if it is satisfied that the auditor of a company has, whether directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers, it may, by order, direct the company to change its auditors.

However, if the application is made by the Central Government and the Tribunal is satisfied that any change of the auditor is required, it shall within fifteen days of receipt of such application, make an order that he shall not function as an auditor and the Central Government may appoint another auditor in his place.

It may be noted that an auditor, whether individual or firm, against whom final order has been passed by the Tribunal under this section shall not be eligible to be appointed as an auditor of any company for a period of five years from the date of passing of the order and the auditor shall also be liable for action under section 447.

It is hereby clarified that the case of a firm, the liability shall be of the firm and that of every partner or partners who acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its director or officers.

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(d) Differences between Division II (Ind- AS- Other than NBFCs) and Division III (Ind- AS- NBFCs) of Schedule III: The presentation requirements under Division III for NBFCs are similar to Division II (Non NBFC) to a large extent except for the following:

(i) NBFCs have been allowed to present the items of the balance sheet in order of their liquidity which is not allowed to companies required to follow Division II. Additionally, NBFCs are required to classify items of the balance sheet into financial and non-financial whereas other companies are required to classify the items into current and non-current.

(ii) An NBFC is required to separately disclose by way of a note any item of 'other income' or 'other expenditure' which exceeds 1 per cent of the total income. Division II, on the other hand, requires disclosure for any item of income or expenditure which exceeds 1 per cent of the revenue from operations or ₹ 10 lakh, whichever is higher.

(iii) NBFCs are required to separately disclose under 'receivables', the debts due from any Limited Liability Partnership (LLP) in which its director is a partner or member.

(iv) NBFCs are also required to disclose items comprising 'revenue from operations' and 'other comprehensive income' on the face of the Statement of profit and loss instead of showing those only as part of the notes.

(v) Separate disclosure of trade receivable which have significant increase in credit risk & credit impaired.

(vi) The conditions or restrictions for distribution attached to statutory reserves have to be separately disclose in the notes as stipulated by the relevant statute.

(e) Technology based/Digital Forensics Techniques: Every transaction leaves a digital footprint in today's computer-driven society. Close scrutiny of relevant emails, accounting records, phone logs and target company hard drives is a requisite facet of any modern forensic audit. Before taking steps such as obtaining data from email etc. the forensic auditor should take appropriate legal advice so that it doesn't amount to invasion of privacy. Digital investigations can become quite complex and require support from trained digital investigators. However, many open-source digital forensics tools are now available to assist in this phase of the investigation.

Cross Drive Analysis	EnCase
Live Analysis	MD5
Deleted Files	Tracking Log Files
Stochastic Forensics	PC System Log
Steganography	Free Log Tools

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PAPER 4: CORPORATE AND ECONOMIC LAWS

PART – I: RELEVANT MATERIALS FOR MAY 2021 EXAMINATION

For May 2021 examinations for Paper 4: Corporate and Economic Laws, relevant material is of November 2020 edition containing relevant amendments made latest by 31st October 2020.

Besides, refer booklet on MCQS and Case scenarios of January 2021 edition containing Independent MCQs and Case Scenarios on the topics covered under the study material for 30 marks segment of MCQs in the Examination.

Read thoroughly the study material first and then go with the said booklet to have practice and revision of concepts with an analytical and application approach with the thorough understanding of the subject.

PART – II : QUESTIONS AND ANSWERS

DIVISION A: CASE SCENARIO BASED MCQS/ INDEPENDENT MULTIPLE CHOICE QUESTIONS

Case scenario 1

Balfor Ltd., is an unlisted company, having total 70 members, with a paid up capital of ₹ 42,00,000, having turnover of ₹ 200 crore, as per the audited financial statements for the year ended on 31st March, 2020.

5 members holding in total 4% stake in the company, met in person to discuss about the oppression and mismanagement going on in Balfor Ltd. and to do something about it. One of the members, Mr. Ravi, suggested that we five members should file a class action application to the Tribunal to get a resolution in this matter, to which another member, Mr. Jay, told that he is in contact with 3 other members of the company, holding in total 3% stake, who are also finding the activities going on in the company to be unjust. So, five plus three other members i.e. 8 members in total, will be able to file an application to the Tribunal under section 244 of the Companies Act, 2013.

The application of complaint for oppression and mismanagement was filed to the Tribunal on 4th June, 2020, with the consent of aforesaid 8 members of the company. The said application provided the details of an agreement made by Balfor Ltd. with Mr. Dev, a relative of director of Balfor Ltd., Mr. Raj, with respect to continuous supply of raw materials to Balfor Ltd., for which Mr. Raj, had received certain commission from Mr. Dev, in cash, for offering the contract to him. Also, another director, Mr. Jayesh, had improperly transferred a property of Balfor Ltd. on 6th March, 2020, to Mr. Prakash.

The Tribunal on receipt of such application, made an order, directing investigation into the affairs of Balfor Ltd. Also, the agreement made with Mr. Dev was ordered to be terminated after giving notice to Mr. Dev and obtaining his consent. However, no compensation was ordered to be paid to Mr. Dev for such cancellation of agreement. The contract with respect to property transferred

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by Mr. Jayesh was also ordered to be set aside, as it would have been deemed to be a fraudulent preference, in case such transaction was made by an individual in his insolvency.

Simultaneously, the Central Government ordered for the investigation into the affairs of Balfor Ltd., on receipt of the order from the Tribunal and the task of such investigation was assigned to the Serious Fraud Investigation Office. The Director of Serious Fraud Investigation Office, on getting such order from the Central Government, designated 3 inspectors for such investigation and soon, the investigation got started by the designated persons.

One of the Investigating officers, Mr. Vaibhav, issued summons, to 2 employees, of Balfor Ltd., Mr. Karan and Mr. Arjun, respectively, as well as, to Mr. Daya, an employee of Kafor Ltd., an associate company of Balfor Ltd., after taking the requisite approvals.

The aforesaid persons attended at the place at which they were summoned by Mr. Vaibhav and were examined on oath, one after the other. During the said examination, Mr. Vaibhav, took down notes in writing and he read over the notes taken by him, to all the persons examined, after the end of examination. After hearing the said notes, Mr. Karan and Mr. Arjun, signed the document on which such notes were written but Mr. Daya, refused to sign such document without any reasonable cause for the same, on the same day, but then he thought there would be no issue in signing and so he signed the same after 20 days.

Mr. Vaibhav, forwarded the notes taken by him to the Assistant Director of Serious Fraud Investigation Office, Mr. Ramanuj, and on the basis of such notes, he derived that Mr. Arjun has committed an offence under section 447 of the Companies Act, 2013 which Mr. Ramanuj reconfirmed with Mr. Vaibhav, via email.

Mr. Ramanuj, accordingly, passed an order for arrest of Mr. Arjun, after recording in writing the reasons for such arrest and he immediately forwarded the copy of order of such arrest to the concerned authority along with the document containing notes taken by Mr. Vaibhav at the time of examination of Mr. Arjun, which indicated that he has committed an offence under section 447 of the Companies Act, 2013.

Balfor Ltd., on coming to know of such arrest of Mr. Arjun, wanted to give termination to him and also wanted to demote Mr. Karan to position of junior assistant from his position of senior assistant in the company, during the pendency of investigation and for that purpose it made an application to the Tribunal for the same on 10th October, 2020.

In response to the said application from Balfor Ltd., the Tribunal passed an order on 26th October, 2020 allowing the termination to be given to Mr. Arjun but it objected to the decision of the company for reduction in rank of Mr. Karan from his current position, against which Balfor Ltd. filed an application with the appellate tribunal on 15th November, 2020.

Multiple Choice Questions:

1. State in the light of the given facts , whether, the five members holding in total 4% stake in Balfor Ltd., or the eight members, holding in total 7% stake in Balfor Ltd., were eligible for filing application for class action or/ and u/s 244, respectively, of the Companies Act, 2013?

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(a) For filing application for class action, 5 members were eligible and also for filing application u/s 244 of the Companies Act, 2013, 8 members were eligible.

(b) For filing application for class action, 5 members were not eligible and also for filing application u/s 244 of the Companies Act, 2013, 8 members were not eligible.

(c) For filing application for class action, 5 members were eligible but for filing application u/s 244 of the Companies Act, 2013, 8 members were not eligible.

(d) For filing application for class action, 5 members were not eligible but for filing application u/s 244 of the Companies Act, 2013, 8 members were eligible.

2. Whether the decision of Tribunal can be considered as valid with respect to termination of agreement made by Balfor Ltd. with Mr. Dev as well as setting aside the contract of transfer of property, respectively?

(a) The decision of tribunal for termination of agreement made by Balfor Ltd. with Mr. Dev can be considered as valid. Also, the decision of setting aside the contract of transfer of property, can be considered as valid as such transfer was made within 6 months before the date of making application to the tribunal.

(b) The decision of tribunal for termination of agreement made by Balfor Ltd. with Mr. Dev cannot be considered as valid as no compensation was ordered to be paid to Mr. Dev. Also, the decision of setting aside the contract of transfer of property, cannot be considered as valid as such transfer was not made within 90 days before the date of making application to the tribunal.

(c) The decision of tribunal for termination of agreement made by Balfor Ltd. with Mr. Dev can be considered as valid. Also, the decision of setting aside the contract of transfer of property, can be considered as valid as such transfer was made within 3 months before the date of making application to the tribunal.

(d) The decision of tribunal for termination of agreement made by Balfor Ltd. with Mr. Dev cannot be considered as valid as no compensation was ordered to be paid to Mr. Dev. However, the decision of setting aside the contract of transfer of property, can be considered as valid as such transfer was made within 3 months before the date of making application to the tribunal.

3. Prior approval of which authority would have been sufficient for Mr. Vaibhav for examining Mr. Daya, on oath, and how much maximum amount of fine could be levied on Mr. Daya for refusing to sign the document containing the notes taken down by Mr. Vaibhav?

(a) Prior approval of Director of Serious Fraud Investigation Office would have been sufficient for Mr. Vaibhav and maximum amount of fine that could be levied on Mr. Daya is ₹ 1,00,000.

(b) Prior approval of Central Government would have been sufficient for Mr. Vaibhav and maximum amount of fine that could be levied on Mr. Daya is ₹ 40,000.

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(c) Prior approval of Director of Serious Fraud Investigation Office would have been sufficient for Mr. Vaibhav and maximum amount of fine that could be levied on Mr. Daya is ₹ 1,40,000.

(d) Prior approval of Central Government would have been sufficient for Mr. Vaibhav and no fine that could be levied on Mr. Daya as he has signed the said document within 30 days of being examined on oath.

4. Whether Mr. Ramanuj was having the authority to exercise power to make an order of arrest of Mr. Arjun on the basis of notes of examination received from Mr. Vaibhav and to which authority, Mr. Ramanuj would have forwarded the copy of arrest order along with the document containing notes?

   (a) No, as such notes can't be considered as a material or evidence in his possession to be used against Mr. Arjun and Mr. Ramanuj would have forwarded the copy of arrest order along with the document containing notes to the Serious Fraud Investigation Office.

   (b) Yes, as such notes constitute valid evidence to be used against Mr. Arjun and Mr. Ramanuj would have forwarded the copy of arrest order along with the document containing notes to the Central Government.

   (c) No, as such notes can't be considered as a material or evidence in Mr. Ramanuj's possession to be used against Mr. Arjun and Mr. Ramanuj would have forwarded the copy of arrest order along with the document containing notes to NCLT.

   (d) Yes, as such notes constitute valid evidence to be used against Mr. Arjun and Mr. Ramanuj would have forwarded the copy of arrest order along with the document containing notes to the Serious Fraud Investigation Office.

5. What was the last date available with Tribunal to give response to the application made by Balfor Ltd. with respect to its employees as well as with Balfor Ltd. to file appeal with the appellate tribunal?

   (a) 10th November, 2020 and 26th November, 2020, respectively.

   (b) 9th November, 2020 and 25th November, 2020, respectively.

   (c) 10th November, 2020 and 25th December, 2020, respectively.

   (d) 9th November, 2020 and 26th November, 2020, respectively.

Case scenario 2

Shri Hari Textiles Limited was incorporated in the year 2010. Its Registered Office is situated in Connaught Place, New Delhi. It filed its audited annual financial statements for the financial year 2019-20 well within time with the jurisdictional Registrar of Companies. The Registrar inspected the statements and after reviewing them, felt the need to seek clarifications on certain matters. Accordingly, a written notice was sent by the Registrar to the company and its officials

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directing them to comply with the notice within thirty days of its receipt. However, the company and its officials failed to reply within the time specified in the notice.

The Registrar initiated the inquiry and proceeded further for inspecting all the documents of the company. While conducting the inquiry, the Registrar on prudent grounds believed that some of the documents and other vital information in relation to the company would be destroyed or altered by the official of the company. With a view to safeguard the documents, the Registrar obtained an order from the Special Court and thereafter, seized all such material.

While inspecting some of the documents the Registrar came to know that the Board of Directors had passed a resolution in a Board Meeting held on 10-04-2019 and thereby, increased the remuneration payable to the directors including two whole-time directors and Managing Director to 12% of the net profits of the company which was a sharp increase of 5% from the preceding financial year.

Prior to the inquiry, two directors of the company, namely, Mr. X and Mr. D got retired. The Registrar found from the inspection of the documents that they were involved in certain dealings which included selling of the assets of the company. On the basis of such information gathered from the inspected documents, the Registrar sought some clarifications from both of them regarding the dubious transactions. However, both Mr. X and Mr. D refused to appear before him showing their non-availability in the town and also represented through a common representative that they were no more a part of the Board of Directors of Shri Hari Textiles Limited.

After the completion of inspection and inquiry, the Registrar submitted a written report to the Central Government in respect of his findings against the company. The reports mentioned that there were major discrepancies in the assets and liabilities as well as profit and loss statements filed by the company.

On receipt of report from the Registrar, the Central Government considered it necessary to investigate the affairs of the company by the Serious Fraud Investigation Office (SFIO). Accordingly, by an order SFIO was directed to conduct the investigation of Shri Hari Textiles Limited and submit its report within the stipulated time. As instructed by the Central Government, SFIO authorised some of its inspectors to investigate the affairs of the company. The team deputed by the SFIO included experts in the field of cost accounting, financial accounting, taxation, law and forensic auditing.

While inspecting the company, the team of SFIO came to know that the Income-tax authorities had already initiated investigation against Shri Hari Textiles Limited.

Multiple Choice Questions (MCQs) [2 Marks each]

6. Shri Hari Textiles Limited and its officials failed to submit any reply to the written notice issued by the Registrar within the time specified in the notice. How much fine can be imposed for such failure?

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(a) The Company and every defaulting officer shall be punishable with a fine up to ₹ 1,00,000 and in case of continuing failure, with an additional fine up to ₹ 500 for every day after the first during which the failure continues.

(b) The Company and every defaulting officer shall be punishable with a fine up to ₹ 1,50,000 and in case of continuing failure, with an additional fine up to ₹ 1,000 for every day after the first during which the failure continues.

(c) The Company and every defaulting officer shall be punishable with a fine up to ₹ 1,00,000 and in case of continuing failure, with an additional fine up to ₹ 5,000 for every day after the first during which the failure continues.

(d) The Company and every defaulting officer shall be punishable with a fine up to ₹ 2,00,000 and in case of continuing failure, with an additional fine up to ₹ 5,000 for every day after the first during which the failure continues.

7. From the case scenario, it is observed that the Registrar seized certain important documents in the course of inquiry. After inspection what procedure is to followed pertaining to such documents?

(a) The Registrar is required to submit such documents in the Special Court which permitted seizure.

(b) The Registrar is required to forward all such documents along with the inquiry report to the Central Government.

(c) The Registrar is required to return such documents back to the company after making, if considered necessary, the copies of them.

(d) The Registrar is required to retain such documents until further instruction is received from the Special Court.

8. What is the requisite requirement for increasing the remuneration of directors including whole-time directors and Managing Director to 12% so that it shall be in accordance with the relevant provisions of the Companies, Act, 2013?

(a) Board Resolution increasing the remuneration to 12% needs to be authorised at the General Meeting and thereafter, duly sanctioned by the ROC.

(b) Board Resolution increasing the remuneration to 12% needs to be authorised at the General Meeting and thereafter, duly sanctioned by the Tribunal.

(c) Board Resolution increasing the remuneration to 12% needs to be authorised at the General Meeting subject to Schedule V.

(d) Board Resolution increasing the remuneration to 12% needs to be authorised at the General Meeting and thereafter, duly sanctioned by the Central Government through Regional Director.

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9. The case scenario states that the Registrar of Companies had called ex-directors of the company for examining them during the inquiry. Is the Registrar empowered to call the ex-directors:

   (a) The Registrar cannot call ex-directors of the company, without the order of the court.

   (b) The Registrar may, by issuing a written notice, call the ex-directors for seeking the requisite information.

   (c) In case the Registrar is appointed by the Central Government to conduct investigation, then only he can call ex-directors of the company.

   (d) Except the Tribunal, no other authority is empowered to call ex-directors of a company for any examination.

10. According to the case scenario, while inspecting the company, the team of SFIO came to know that the Income-tax authorities had already initiated investigation against the company. From the given options, choose the correct one that indicates as to how in amidst of such a situation, SFIO will be continuing with the investigation.

   (a) SFIO has to put its investigation on hold so long as the company is being investigated by Income-tax authorities.

   (b) SFIO will proceed with its investigation on the basis of report submitted by Income-tax authorities.

   (c) SFIO will proceed with its investigation while Income-tax authorities shall keep on hold its investigation.

   (d) SFIO will simultaneously continue its investigation along with the Income-tax authorities.

INDEPENDENT MCQS [Question 11-22]

11. ABC Ltd incorporated in India want to register as an ARC to commence the business of asset reconstruction. The company made all the arrangement required for the realisation of the financial assets acquired for the purpose of reconstruction of the assets and shall be able to pay periodical returns on respective due dates on the investments made in the company. The directors are well qualified and had nearly 25 years of experience in finance, 10 years of experience in reconstruction and securitisation of assets. The company has also complied with all the requirement of regulations and guidelines issued by Reserve Bank of India. The details of the profits made during the past 3 years are 2016-17 ₹ 200 Cr (Loss), 2017-2018 ₹ 500 Cr (Profit), 2018-2019 ₹ 700Cr. (Profit).

   (a) The ARC can be registered and certificate be issued by RBI, but RBI may not prescribe any further conditions.

   (b) The ARC can be registered and certificate be issued by RBI, but RBI may prescribe any further conditions.

   (c) The ARC registration cannot be made.

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(d) RBI has no power to register ARC, as ARC's are governed by SARFAESI Act, 2002.

12. Proceedings under the Prevention of Money Laundering Act, 2002 were initiated against Mr. Suraj. Through an order, property of Mr. Suraj has been attached under section 8. Mr. Suraj Preferred an appeal to the Appellate Tribunal. Mr. Suraj is adjudicated an insolvent during the pendency of the appeal. What will happen to the proceedings initiated under PMLA in the given case?

    (a) Proceedings will be dispensed with

    (b) His legal representatives will continue proceedings before the Appellate Tribunal

    (c) The official assignee or the official receiver, as the case may be, continue the appeal before the Appellate Tribunal.

    (d) Creditors will continue the proceedings before the Appellate Tribunal

13. Who shall determine the amount of claim due to a creditor under the Insolvency and Bankruptcy Code during the Corporate Insolvency Resolution Process (CIRP)?

    (a) Committee of creditors

    (b) Resolution professional

    (c) Adjudicating Authority

    (d) Corporate debtor

14. Can an Adjudicating Authority order the liquidation of a corporate debtor even after approving the resolution plan:

    (a) Yes, if the resolution plan is contravened.

    (b) The Adjudicating Authority may order the liquidation of a corporate debtor even after approving the resolution plan on receiving an application from a third party who is unaffected by such liquidation

    (c) Yes, the Adjudicating Authority may order for the liquidation of a corporate debtor if the committee of creditor does not approve the resolution plan after its approval by the Adjudicating Authority

    (d) No, the Adjudicating Authority cannot order the liquidation of a corporate debtor after approving the resolution plan.

15. What is the periodicity of submission of report by company liquidator with respect to the progress of winding up of the company to the Tribunal:

    (a) Monthly

    (b) Bi-monthly

    (c) Quarterly

    (d) Half yearly

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16. Mr. X, a resident of India planned a tour of 15 days to visit Paris and to meet his niece living there. While returning to India, Mr. X was carrying with him INR 30,000. Her niece told him that limit is marked on bringing Indian currency notes at the time of return to India. Identify the correct limit :

    (a) INR 2000

    (b) INR 5000

    (c) INR 10,000

    (d) INR 25,000

17. In the case of financing of a financial asset by more than one secured creditors, there secured creditor shall be entitled to exercise any of the rights conferred on him is agreed upon by the secured creditors representing ---------in order to make such an action binding on all the secured creditors.

    (a) Less 60% in value of the amount outstanding as on a record date

    (b) Not less than 60% in value of the amount outstanding as on a record date

    (c) At least 75% in value of the amount outstanding as on a record date

    (d) Not less than 75% in value of the amount outstanding as on a record date

Descriptive Questions [Questions 18- 26]

18. Dharma Ltd. in the light of prospective developments in the infrastructure of company decided to have borrowing on long term basis from financial Institutions. In the Board Meeting held on 15th September, 2020, following proposal of borrowing 2,00,00,000 from Financial institutions on long-term basis was also presented for consideration. As per the given information, in the light of relevant provisions of the Companies Act, 2013, examine the eligibility of the amount up to which the Board can borrow from Financial institution and the state on the validity of the said proposal.

    Following were the Balance Sheets of last three years of Dharma Ltd., containing following facts and figure of financial information :

Particulars	**As at 31.03.2018 ₹**	**As at 31.03.2019 ₹**	**As at 31.03.2020 ₹**
Paid up capital	60,00,000	60,00,000	85,00,000
General Reserve	50,00,000	52,50,000	60,00,000
Credit Balance in Profit & Loss Account	6,00,000	8,50,000	20,00,000
Securities Premium	3,00,000	3,00,000	3,00,000
Secured Loans	20,00,000	25,00,000	40,00,000

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19. Mr. Shariff who was a Key Managerial Personnel (Manager) of XYZ Ltd. retired on 12th May 2020. An examination of the final accounts of the company for the year ended on 31st March 2020, the Registrar of Companies found some serious irregularities in writing off of the huge amounts of bad debts and no satisfactory explanation was provided for the same from the company. In such a situation the Registrar of Companies wants some explanation from the company and Mr. Shariff. In the light of the Companies Act, 2013, examine the situation and advice on the act of Registrar seeking explanation from Mr. Shariff.

20. Mr. M, a member of XYZ Ltd. filed an application before the Tribunal complaining of oppression and mismanagement w.r.t. an agreement entered by XYZ Ltd. effecting the interest of the company. Vide order passed by the Tribunal under section 242 of the Companies Act, 2013, terminated the said agreement. The agreement was entered by Mr. H and Mr. G who was managing director and the executive director of the XYZ Ltd. Mr. Rasik, with whom the XYZ Ltd entered the agreement, filed a petition claiming the loss caused due to termination of the said agreement. Also state the legal position of Mr. H and Mr. G holding their place of office in the said situation. Examine the given facts and address the issues in terms of the relevant provisions of Companies Act, 2013.

21. Mr. Ingenious, who is registered as an Intermediary fails to enter into an agreement with his client and hence penalised by SEBI under the SEBI Act 1992. Advise Mr. Ingenious as to what remedies are available to him against the order of SEBI.

22. A foreign tourist comes to India and he purchases a antiques from a shop. He would like to pay US$ 30 in cash to the shopkeeper. Comment in the light of the FEMA, whether shopkeeper is permitted to accept foreign currency?

23. Comment upon nature of offence committed under the Prevention of Money Laundering Act? In the case, a spouse sold their property in 175 lakh to Mr. Y. In lieu of the sale, they obtained amount 100 lakh through RTGS in his account and rest amount of 75 lakh in cash which he transferred to wife's offshore bank account . Examine the liability of the spouse in the given case in the light of the PMLA, 2002. Also state whether they will be liable to be released on bail.

24. X, is an association having registration to transfer the Foreign Contribution received by it to another organization? Is this the valid act of X? If yes, then what is the process to do so? Is there any restriction on transfer of funds to other organizations?

25. Anil, who is a Chartered Accountant with his own independent practice, is the arbitrator in an arbitration between Tata Tea Inc., and Suzuki Ltd.

    scenarios **I -** Prior to starting his practice, Anil had worked for five years with Tata Tea Inc.

    II – During the proceedings before the arbitral tribunal, Anil would allow Tata Tea to take many liberties, for instance taking as much time for making oral arguments, cross examining the witnesses, for submitting documents, etc. Also the proceedings were adjourned (postponed) whenever so requested by Tata Tea. When Suzuki Motors wanted

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to take extra time they were not allowed. In few instances when they were permitted, they are asked to pay heavy cost to Tata Tea for delaying the proceedings..

Suziki Ltd. on the basis of above scenarios wanted to challenge the appointment of Mr. Anil. State whether the appointment of Mr. Anil as an arbitrator can be challenged?

26. X Inc Ltd is a holding company of Y Infrastructure Ltd. Insolvency resolution process was initiated against the X Inc Ltd on 15th December 2020. In the mean time another financial creditor initiated corporate insolvency resolution process against Y Infrastructure Ltd. Later X Inc Ltd filed an appeal contending that resolution process against Y Infrastructure Ltd. should not continue till corporate insolvency resolution process is decided in the case of X Inc Ltd. on the basis of initiation of moratorium. Also the Resolution plan of X Inc Ltd. approved by CoC, was still pending before the Adjudicating authority for its approval. In the light of given situation, examine whether corporate insolvency resolution process initiated against the X Inc Ltd., can bar the corporate insolvency resolution process initiated against the Y Infrastructure Ltd.?

SUGGESTED ANSWER

DIVISION A: CASE SCENARIO BASED MCQS/ INDEPENDENT MULTIPLE CHOICE QUESTIONS

Answers Keys to MCQs

Question No.	Answer
1.	(a)
2.	(c)
3.	(c)
4.	(d)
5.	(b)
6.	(a)
7.	(c)
8.	(c)
9.	(b)
10.	(c)
11.	(c)
12.	(c)
13.	(b)
14.	(a)

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15.	(c)
16.	(d)
17.	(b)

DIV B: Descriptive Questions [Questions 18- 26]

18. **Borrowing from Financial Institutions:** As per Section 180(1)(c) of the Companies Act, 2013, the Board of Directors of a company, without obtaining the approval of shareholders in a general meeting, can borrow money including moneys already borrowed up to an amount which does not exceed the aggregate of paid up capital of the company, free reserves and securities premium. Such borrowing shall not include temporary loans obtained from the company's bankers in the ordinary course of business. Here, free reserves do not include the reserves set apart for specific purpose.

    Since the decision to borrow is taken in a meeting held on 15th September, 2020, the figures relevant for this purpose are the figures as per the Balance Sheet as at 31.03.2020. According to the above provisions, the eligibility of Board of Directors of Dharma Ltd.to borrow up to an amount is calculated as follows:

Particulars	₹
Paid up Capital	85,00,000
General Reserve (being free reserve)	60,00,000
Credit Balance in Profit & Loss Account (to be treated as free reserve)	20,00,000
Securities Premium	3,00,000
Aggregate of paid-up capital, free reserves and securities premium	1,68,00,000
Total borrowing power of the Board of Directors of the company, i.e, 100% of the aggregate of paid-up capital, free reserves and securities premium	1,68,00,000
Less: Amount already borrowed as secured loans	40,00,000
Amount up to which the Board of Directors can further borrow	1,28,00,000

    Dharma Ltd. is entitled to borrow ₹1,28,00,000 through board of directors. As in the given case proposal of borrowing was Rs, 2,00, 00, 000 which is more than eligibility to borrow, therefore, Dharma Ltd, have to seek approval of shareholders in general meeting. As the proposal of borrowing ₹ 2,00,00,000 from Financial institutions on long-term basis was presented for consideration in Board Meeting without approval of shareholders in general meeting, therefore said proposal is invalid.

19. As per the provisions of Section 206(2) of the Companies Act, 2013, the Registrar can call for any information or explanation or any other further documents related to the company from the company or any officer if the company, which he thinks, is necessary for deciding

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any matter of the company. Proviso to Section 206(2) provides that, where such information or explanation relates to any past period, the officers who had been in the employment of the company for such period, if so called upon by the Registrar through a notice served on him, in writing, shall also furnish such information or explanation to the best of their knowledge. So, in the given case Mr. Shariff, the ex-manager of the company can be called upon for such information/explanation which was related to their period of service.

20. As per section 243 of the Companies Act, 2013 , where an order made under section 242 terminates, sets aside or modifies an agreement which was entered by the company, were in a manner prejudicial to the interests of the company,—

(a) such order shall not give rise to any claims whatever against the company by any person for damages or for compensation for loss of office or in any other respect either in pursuance of the agreement or otherwise;

(b) no managing director or other director or manager whose agreement is so terminated or set aside shall, for a period of five years from the date of the order terminating or setting aside the agreement, without the leave of the Tribunal, be appointed, or act, as the managing director or other director or manager of the company:

Accordingly, Mr. Rasik, with whom the XYZ Ltd entered the agreement, filed a petition claiming the loss caused due to termination of the said agreement, is not viable. Further, Mr. H and Mr. G, managing director and the executive director of the XYZ Ltd. who entered agreement with Mr. Rasik which was ordered to be terminated by the Tribunal, shall not act as the managing director or other director or manager of the company, for a period of five years from the date of the order terminating or setting aside the agreement, without the leave of the Tribunal.

21. **Remedies against SEBI order:** Section 15B of the Securities and Exchange Board of India Act, 1992 lays down that if any person, who is registered as an intermediary and is required under this Act or any rules or regulations made there under, to enter into an agreement with his client, fails to enter into such agreement, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less. Mr. Ingenious has been penalised under the above mentioned provision. Two remedies are available to Mr. Ingenious in this matter:-

(i) **Appeal to the Securities Appellate Tribunal:** Section 15T of the SEBI Act, 1992 states that any person aggrieved,—

(a) by an order of the Board made, on and after the commencement of the Securities Laws (Second Amendment) Act, 1999, under this Act, or the rules or regulations made thereunder; or

(b) by an order made by an adjudicating officer under this Act; or

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(c) by an order of the Insurance Regulatory and Development Authority or the Pension Fund Regulatory and Development Authority, may prefer an appeal to a Securities Appellate Tribunal having jurisdiction in the matter.

Every appeal shall be filed within a period of forty-five days from the date on which a copy of the order made by the Board or the Adjudicating Officer or the Insurance Regulatory and Development Authority or the Pension Fund Regulatory and Development Authority, as the case may be, is received by him and it shall be in such form and be accompanied by such fee as may be prescribed :

Provided that the Securities Appellate Tribunal may entertain an appeal after the expiry of the said period of forty-five days if it is satisfied that there was sufficient cause for not filing it within that period.

On receipt of an appeal under sub-section (1), the Securities Appellate Tribunal may, after giving the parties to the appeal, an opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or setting aside the order appealed against.

The Securities Appellate Tribunal shall send a copy of every order made by it to the Board, or the Insurance Regulatory and Development Authority or the Pension Fund Regulatory and Development Authority, as the case may be the parties to the appeal and to the concerned Adjudicating Officer.

The appeal filed before the Securities Appellate Tribunal under sub-section (1) shall be dealt with by it as expeditiously as possible and endeavor shall be made by it to dispose of the appeal finally within six months from the date of receipt of the appeal.

(ii) **Appeal to the Supreme Court:** Section 15Z of the SEBI Act, 1992 provides that any person aggrieved by any decision or order of the Securities Appellate Tribunal may file an appeal to the Supreme Court within 60 days from the date of communication of the decision or order to him on any question of fact or law arising out of such order. The Supreme Court may, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding 60 days.

22. As per section 3 of the FEMA, save as otherwise provided in this Act, rules or regulations made thereunder, or with the general or special permission of the Reserve Bank, no person shall receive otherwise than through an authorised person, any payment by order or on behalf of any person resident outside India in any manner.

Where any person in, or resident in, India receives any payment by order or on behalf of any person resident outside India through any other person (including an authorised person) without a corresponding inward remittance from any place outside India, then, such person shall be deemed to have received such payment otherwise than through an authorised person;

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Here in the given case, the foreign tourist wanted to pay foreign currency in cash on purchase of antiques to shopkeeper which as per section 3, is not permissible to any person to receive any payment by order or on behalf of any person resident outside India in any manner except received through an authorised person. Therefore, the Shopkeeper cannot accept cash as it will be a receipt otherwise than through Authorised Person except where the shopkeeper have taken a money changers license to accept foreign currency.

23. **Nature of offence committed under the Act:** Section 45 of the PMLA, 2002, provides that the offences under the Act shall be cognizable and non-bailable. Person accused of an offence under this Act shall not be released on bail or on his own bond unless-

(i) The Public Prosecutor has been given an opportunity to oppose the application for such release and

(ii) Where the Public Prosecutor opposes the application, the court is satisfied that there are reasonable grounds for believing that he is not guilty of such offence and that he is not likely to commit any offence while on bail.

Exceptions: In case of any person who is under the age of 16 years or in case of a woman or in case of a sick or infirm or is accused either on his own or along with other co-accused of money-laundering a sum of less than one crore rupees, may be released on bail, if the Special Court so directs.

As per the said section the spouse, are liable for commission of an offence of money laundering by transferring an unaccounted money obtained through sale of their property to an offshore bank account of his wife with an intent to evade tax. As the husband and his wife, i.e., the spouse jointly acted in the commission of the act of money-laundering of a sum less than one crore rupees (75 lakh which was paid in cash), so the wife may be released on bail, if the Special Court so directs. Whereas the Husband shall be released on bail/on his own bond only on compliance with above stated provision.

24. Yes, X can transfer the Foreign Contribution received by it to another organization as per section 7 of FCRA, 2010. According to the provision 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 unless such other person is also registered and had been granted the certificate or obtained the prior permission under this Act:

Provided that such person may transfer, with the prior approval of the Central Government, a part of such foreign contribution to any other person who has not been granted a certificate or obtained permission under this Act in accordance with the rules made by the Central Government."

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Restrictions on transfer: Rule 24 of FCRR, 2011, prescribes the procedure for transferring foreign contribution to any unregistered person as under:

(1) A person who has been granted a certificate of registration or prior permission under section 11 and intends to transfer part of the foreign contribution received by him to a person who has not been granted a certificate of registration or prior permission under the Act, may transfer such foreign contribution to an extent not exceeding ten per cent of the total value thereof and for this purpose, make an application to the Central Government in the prescribed Form.

(2) Every application made above shall be accompanied by a declaration to the effect that-

(a) the amount proposed to be transferred during the financial year is less than ten per cent of the total value of the foreign contribution received by him during the financial year;

(b) the transferor shall not transfer any amount of foreign contribution until the Central Government approves such transfer.

(3) A person who has been granted a certificate of registration or prior permission under section 11 shall not be required to seek the prior approval of the Central Government for transferring the foreign contribution received by him to another person who has been granted a certificate of registration or prior permission under the Act provided that the recipient has not been proceeded against under any of the provisions of the Act.

(4) Both the transferor and the recipient shall be responsible for ensuring proper utilisation of the foreign contribution so transferred and such transfer of foreign contribution shall be reflected in the returns in Form to be submitted by both the transferor and the recipient."

25. As per section 12 of the Arbitration and Conciliation Act, 1996, when a person is approached in connection with his possible appointment as an arbitrator, he shall disclose in writing any circumstances-

a. such as existence either direct or indirect of any past or present relationship with or interest in any of the parties or in relation to the subject matter in dispute, whether financial, business, professional or other kind, which is likely to give rise to justifiable doubts as to his independence or impartiality; and

b. which are likely to affect his ability to devote sufficient time to the arbitration and in particular his ability to complete the entire arbitration within a period of twelve months.

In the first case Anil had worked for five years with Tata Tea Inc. In this situation the law would deem Anil to be lacking independence.

In second case, arbitrator by his / her behaviour gives an impression that he is favouring one party over the other.

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An arbitrator may be challenged only if circumstances exist that give rise to justifiable doubts as to his independence or impartiality. In the given scenarios, it would be deemed that Anil to be lacking independence and whereas in the second case it clearly reflects that arbitral tribunal favours and is partial towards Tata Tea, and therefore lacks impartiality. Yes, appointment of Mr. Anil as an arbitrator can be challenged.

26. In the given case, both the X Inc Ltd. and Y Infrastructure Ltd. in the eyes of law are separate entity. Further section 14 of IBC, 2016 which deals with moratorium, no where prohibits initiation of corporate insolvency resolution process on the subsidiary company or its holding company. Further also that a separate CIRP has been initiated against another corporate debtor by another financial creditor, which is altogether separate and have no connection with the CIRP initiated against X Inc Ltd. or Y Infrastructure Ltd.

Therefore, in the given case, corporate insolvency resolution process initiated against the X Inc Ltd, which is a holding company, cannot bar the corporate insolvency resolution process initiated against the Y Infrastructure Ltd which is its subsidiary or vice versa.

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PAPER – 5: STRATEGIC COST MANAGEMENT AND PERFORMANCE EVALUATION

××× CASE STUDY ×××

Porter's Five Forces Model

1. **Safe and Wise Advisory Limited (SWAL)** is well established financial planning & risk advisory firm of the country with nation-wide presence. SWAL is engaged in selling third party products be it financial products or insurance products (life assurance only). Financial advisory business of SWAL is doing well and contributing to the half of gross revenue of group and two-third of overall group's bottom line, but insurance brokerage business is not performing as per expectation. 'Independent and impartial advice' to client is unique selling point of SWAL.

   SWAL was established by Mr. Kaushal Jaiswal around two decade ago (when life-assurance business goes private), at then it was one division business i.e. assurance brokerage business. Mr. Kaushal Jaiswal is dynamic leader and presently leading the company as CEO, apart from being major shareholder of the company.

   SWAL is widely acknowledged in market for two distinct features, first being presence wide across the nation, in form of 'sub-agency offices' equipped with professionally trained sale staff headed by financial planner or advisor, where customer can take advise and discuss opinion prior to investing/ buying any insurance or financial product. SWAL has 'sub-agency offices' in 580 cities, towns and blocks. Locations are semi-commercial in nature but prominent. SWAL has practice to sign 30-year lease, when so ever taking and 'sub-agency office' on lease in order to reduce the lease cost and bring stability.

   Secondly, SWAL sold product of all third parties, hence provide a range of products to its client to choose from. In 2010, SWAL signed a 15 year's agency agreement with all 23 life insurance companies recognised then. SWAL's tagline is also depicting the same 'we are ethically committed to understand and deliver your needs'. SWAL believes in organic growth and listed on stock market 3 years back to float additional capital to fund more 'sub-agency offices'.

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22 out of these 23 life assurance companies are private and registered themselves with regulatory between the year 2000-2009 for a period of 25 years. Considering the default by few insurance firms and increasing customer complaints, regulator of insurance business in country tighten the registration criteria and harden the norms.

Typically each of 'sub-agency office' comprises three regular and one contractual employee. One being financial planner/ advisor, 2 sales and relationship officer and contractual worker in role of support staff and vested with miscellaneous clerical responsibilities. The on-roll number of employees engaged in assurance brokerage business has been increased to 1,564 from 720 five year ago (up-till 3 year ago number was 845 but since expansion of 'sub-agency' office division it is around 1,500).

Market trend is changing, since the SWAL commence the business. Each of such insurance company, now has their own network of branch offices to sale their insurance product directly; that too at more prominent locations. SWAL counter this step by highlighting its 'independence and impartial advice' practice, although SWAL managed to retain the revenue at same level, but this result in low profitability of 'sub-agency office' business. Now these insurance companies are not authorising any new agent.

Being in service industry and further in order to ensure wider market reach to compensate the loss of profitability in 'sub-agency office' business, SWAL has established own 'E-platform'- 'Policy at you click' to sell the insurance product with total staff of 50 professionals; as a separate division under insurance brokerage business from 'sub-agency office' division. 'E-platform' division is prospering but 'sub-agency office' business is certainly in trouble.

Supported by revenue figures given below (in '000 Crores), analysts reach to conclusion that growth in the assurance brokerage business is slowing down both for SWAL and industry overall–

Market Size/Year	2019-20	2018-19	2017-18	2016-17	2015-16
SWAL's assurance brokerage business	326	320	312	298	280
Total market size of life assurance	2,240	2,198	2,122	2,004	1,960

Revenue earned by each division of assurance brokerage business (in term of age of the client), is shown in table below for year 2019-20–

Division/Age	20-30	30-40	40-50	50-60	60+	Total
'Sub-agency office' division	2	25	38	164	51	280
'E-platform' division	8	28	8	2	0	46
					Total Business of SWAL	326

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Since the profitability of 'sub-agency office' division is declining, hence the strategic review committee of board of directors are concerned about the company's declining profitability due to poor performance of 'sub-agency office' division and suggest that the 'sub-agency office' division should be sold off and that SWAL shall re-position its assurance business as an online solution.

Extract from financial statement for agency office division only (figures in ʼ000 Crores) –

Particulars/Year	2019-20	2018-19	2017-18
Revenue	280	272	250
Profit before interest and tax	18	16	31
Shareholder's' Equity	156	150	150
8% Long term debt	78	64	50
Current Liabilities	455	437	395
Current Assets	605	565	540

Applicable tax rate is 22%. The nature of cost incurred by 'sub-agency office' division is more or less balanced between the variable and fixed. Fixed costs are largely committed in nature.

But the CEO is not agreed to the suggestion made by strategic planning committee, because CEO is of belief that SWAL's USP or original business model is 'sub-agency offices' through which they ensure 'independence and impartial advice' to their clients.

In next board meeting, board is expected to pass resolution on this agenda item in order to decide either to continue or sale the 'sub-agency office' division.

Required

(i) ASSESS the competitive environment of life-assurance business of SWAL (including 'sub-agency office' division). ***[present only two appropriate points for each phase of assessing the environment]***

(ii) EVALUATE the case for holding the 'sub-agency office' division, backed by financial viability among other criteria. ***[present only two appropriate points for each monetary and the non-monetary issue]***

×××QUESTIONS×××

Overall Equipment Effectiveness (OEE)

2. **Sheetal Bearing Balls Limited (SBBL)** is the famous name for bearing balls of different sizes. Mr. Syal recently joined as Manager Production and Operations at Unit 3 of Ludhiana (in Punjab) plant of the SBBL, wherein 10mm diameter steel ball bearings for bicycles are manufactured. The plant is largely automated and lashed with the latest technology machines.

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From Mr. Singh, Plant Accountant Mr. Syal come to know that since machines are of the latest technology and workers are motivated due to the liberal workman policy of SBBL, hence productivity and quality is and was never an issue, but availability is. Over lunch, when Mr. Syal greets Mr. Kumar, Plant Head, he also expresses his worry over excessive downtime and optimal use of limiting factors.

Mr. Syal, while navigating the ERP and reviewing the files & other documents handed over to him, which was prepared and maintained by his predecessor; come across the OEE rate of 93.555% measured during last week for machine '107-10M-Bearing' (which is limiting factor – caused bottleneck activity) during a normal shift. Since the said machine has a high-performance rate of 105%; hence Mr. Syal decided to dig deep into the composite OEE.

In the normal shift of 9 hours workers are allowed to take 2 short breaks of 15 minutes each and a lunch break of 30 minutes. During such a normal shift, out of the total manufactured 27,216 bearing balls by said machine, only 272 balls are found defective.

Required

(i) DETERMINE the unplanned downtime witnessed by machine 107-10M-Bearing and advise Mr. Syal, the best way-out to reduce the same (in brief).

(ii) MEASURE the Ideal Cycle Time to manufacture a single bearing ball.

(iii) APPLY, Goldratt's five steps that can be applied to remove the bottleneck at the Ludhiana plant of SBBL.

Environmental Management Accounting

3. Sheetal Paper Mart (SPM) is in process of getting ISO 14001:2004 Environmental Management Systems (revised ISO 14001:2015) certification. SPM is selling eco-friendly and wheat straw-based paper of different sizes (A3, A4, and A5) and GSM under the brand 'Prime'. Prime is a famous name among both commercial and household consumers.

For purpose of getting certified, a cross-functional team is constituted, which is responsible ***'to improve the environmental impact & image of SPM as eco-friendly enterprise and control environmental cost'***, which collects the following particulars relating to the H1 and H2 (first and second half of the relevant fiscal year respectively)

Disposing of the toxic material costs ₹1.2 crores to SPM in H2 which is 20% lesser than what was spent during H1. Committee responsible for formulating policy matters on environment-related aspects in SPM has departmental budget of ₹6 lakhs p.a., in H1 the utilisation rate was 80% and in H2 it was 110%.

Environmental audits earlier used to conduct on a half-yearly basis, but management decided to reduce the frequency to quarter each, in the mid of such year. Each such audit

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cost ₹8 lakhs to SPM. In the H2 SPM extends the production capacity and installed the new plant & machinery which has put to use cost of ₹77.25 crores, this is the premium version of the plant and machine due to its capability to reduce the generation of waste. Erection and other installation costs including dry-run were ₹65 lakhs and the same for all versions. The standard version has on-board cost of ₹76.20 crores.

SPM is practicing the recycling policy, which was formulated around three years ago; for the scrap, it generates in its plant. The review of the recycling policy is pending for the last 12 months. The cost incurred during the fiscal year was ₹2.75 crores, spent in alignment to scrap generated during the year. The policy document also states– *'zero discharge of waste/scrap into the environment, in order to be true-sense eco-friendly enterprise'*.

In H2 contamination test was performed which cost ₹4 lakhs to SPM. The monitoring cost incurred during the year was ₹78 lakhs; in H2 this was double then H1.

Required

(i) PREPARE the environmental cost statement as per the classification suggested by 'Hanson and Mendoza'.

(ii) ANALYSE the elements of environmental cost at SPM.

(iii) EVALUATE whether the cross-functional team is successful in serving their 'terms of reference'.

Note- Clearly State the assumptions (if any).

Annexure

Scrap Generated (during the year)

Quarter	First	Second	Third	Fourth
Scrap generated and recycled	1,572 MT	1,428 MT	1,114 MT	886 MT

Cellular Manufacturing

4. It has been resolved that cellular manufacturing shall be adopted in order to improve productivity, in the recent board meeting of **Raptor Bearing and Shaft Limited**. In favour of the resolution, Mr. Nayak (the executive director) who is responsible for production and operation function gave a briefing over different layouts of cells. The Managing Director, Mr. Syal believes that each possible cell formation and layout need to be studied in advance by a cross functional team.

Chief HR officer Mr. Mishra shown his concern over the utility of cellular manufacturing to enhance productivity. In response to him, Mr. Nayak mentioned *'Although scientific management is quite an old theory of management pronounced by Frederick Winslow Taylor, which analyses and synthesizes workflows with the objective of improving*

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economic efficiency, especially labour productivity; but still has relevance. This relevance multi-folds when Time and Motion studies are considered in nexus with cellular manufacturing'.

Mr. Nayak constituted a cross-functional team with the term of reference stated in said board resolution. You are also part of teams as a representative of Management Accounting Division. The team started with the study of different possible layouts and machine cell designs. While analysing the production flow it is observed that 5 different parts/ components (P101, P104, P105, P107, and P108) are complexly involved in processing at 5 different machines (M2, M7, M13, M13A, and M15).

Part-Machine Incident Matrix for Production Flow Analysis for the said product is given below–

	P101	P104	P105	P107	P108
M2	1*				
M7		1#			1
M13	1*			1	
M13A		1#	1		
M15				1	

Interpretation

(*) P101 requires processing at M2 and M13, whereas (#) P104 requires processing at M7 and M13A.

Required

(i) DISCUSS the concern expressed by Mr. Mishra over the utility of cellular manufacturing.

(ii) EXPLAIN on utility of at-least three machine cell designs, which can be used.

(iii) FIND logical part families and machine groups based upon Part-Machine Incident Matrix to showcase Machine-Part grouping using Rank Order Clustering Algorithm.

5. You are newly appointed management consultant with experience in Lean System. During discussion at meeting, managing partner (Mr. Gupta) explain the assembly line workflow process at **RIO** along with the machine part incident matrix. You quoted about your past experience of implementing Cellular Manufacturing system. Mr. Gupta asks you to:

(i) FIND appropriate cells using suitable method.

(ii) COMMENT on the results, if any.

Note- Use "Rank Order Clustering method".

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Machine Shop RIO-042

Machine Part Incident Matrix

Part / Machine	P_1	P_2	P_3	P_4	P_5	P_6
M_b			1		1	
M_c				1	1	1
M_d	1	1				
M_e			1		1	1
M_f	1	1		1		

Manufacturing Cycle Efficiency

6. **Glen Electronics** manufactures a wide range of electronic heaters and geysers. Glen was a popular name among retailers and customers, but it keeps on losing the market share; the major reason is emerging competitors are offering economical product customers with similar features and quality. The market where-in Glen operating is price sensitive, hence adding more features and establish itself as a premium brand is not the option. The only possible choice left with glen is to reduce prices for that it needs to reduce the cost to maintain the profit margin.

   A cost management committee was constituted to study the scenario and recommend the solution to the board of directors. The committee based upon their study suggests a 3-phase solution, out of which phase one is 'stress on enhancing manufacturing cycle efficiency from its current level of 62.50%'. The committee collects the following data with help from the office of the Chief Management Accountant–

   - Current batch wait time before the order getting process is 4 days.
   - The time spent working on the products (batch processing time) is currently 20 days.
   - Total time spent by the products waiting –to be processed, moved, inspected, and delivered (batch queue time) is currently 6 days.
   - Currently, the time spent on making sure that the products are not defective (batch inspection time) is double that time spent in transferring products between workstations (batch move time).

   The Board of directors based upon the committee's report decided to apply cellular manufacturing to reduce unnecessary move time. Based upon decision tasks are allocated to concerned functional managers.

   Managers and workers showed their resistance by stating – "*we are not convinced that cellular manufacturing reduces motions on the production floor*". Some workers even mentioned they are not aware of what is current batch inspection time and batch move time.

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Required

You are deputy to management accountant and was part of the committee, hence board approached you to convince the managers and workers as part for change management.

(i) CALCULATE current batch inspection time and batch move time.

(ii) CALCULATE manufacturing cycle time, and how much is non-value-added time? (in term of days)

(iii) CALCULATE revised manufacturing cycle efficiency if both batch inspection time and batch move time cut down to half of the current level and other elements remain constant.

(iv) What makes cellular manufacturing capable to reduce motions on the production floor and how benefit the workers? EXPLAIN.

Decision Making

7. Micro-Guard Industries Limited (MGIL) is a renowned company for a unique range of thoughtfully-engineered products, designed to provide simplified solutions and upscale your home interiors. MGIL engaged in the manufacturing of Power Systems, Batteries, Wires & Cables, Switch Gears & Modular Switches etc. But MGIL is largely famous for its wide range of Voltage Stabilizers. Each product is manufactured in a separate division.

While planning regarding voltage stabilizers division (VSD) for the first half of the fiscal year 20-21 amid the outbreak of COVID-19, the board get through a report from internal expert committee pertaining to crystal series of voltage stabilizers which says– *'due to restricted availability of the input factors (on account of lock-down by the government), only 40,000 crystal voltage stabilizers (CVS) is expected to manufactured and sold during the first half of fiscal, against the normal capacity of 75,000 per quarter; that too at ₹ 1,600/- per CVS'*. At normal capacity level it incurs the following cost to manufacture and sell single unit of CVS–

Particulars	**Amount (₹)**
Direct material	575
Direct labour	215
Variable overhead	310
Fixed overhead	300
Cost per unit	**1,400**

One of the directors suggested– '*since migrant workers moved to their home states and expected to come back in 3-5 months' time hence it is better to temporary discontinue (lock-out) the production for the first half of fiscal'*. Another director support him by stating– *'it will give the opportunity to our suppliers (or retailers) to clear the old stock available with them'*. On the reference by the board, you (chief management accountant

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at MGIL) provide an estimate to management that 1/3rd fixed overhead at a normal capacity level is unavoidable and additional cost due to discontinue (lock-out) of plant for 6 months and resumption thereafter is ₹ 35 lacs.

Required

You are required to ADVISE the management–

(i) Shall they continue the production of CVS or temporary discontinue (lock-out) for the first half of the fiscal year? (consider monetary aspects)

(ii) The qualitative factors which need to consider, while deciding either discontinue (lock-out) or continue.

(iii) What are the minimum number of CVS that VSD needs to manufacture and sell; in order to economically justify the continuation of the production?

Note*– In a legal sense, Lock-out means the temporary closing of a place of employment or the suspension of work, or the refusal by an employer to continue to employ any number of persons employed by him; which is way different from shut-down. But in management accounting lock-out and shutdown both carry the same meaning.*

Pricing Strategy

8. **Zutus Ltd.** is a leading Indian Pharmaceutical company which is a fully integrated, global healthcare provider. With in-depth domain expertise in the field of healthcare, it has strong capabilities across the spectrum of the pharmaceutical value chain. Zutus has earned reputation worldwide amongst pharmaceutical companies for providing comprehensive and complete healthcare solutions.

   One of the drugs, Rifmn is an antibiotic used to treat contagious disease "Tbis". Rifmn is a patented medicine. The patent for which is now going to expire, and several other competitors are expected to enter in the market for selling the medicine using the same components of chemicals, under different other name. In order to reposition itself in the market, the company is reviewing its pricing policy considering the market change and other threat.

   The market research for Rifmn indicates that for every ₹4 decrease in price, demand would be expected to increase by 8,000 batches, with maximum demand for Rifmn being one million batches.

   Each batch of Rifmn is currently made of using chemical salts:

   Salt X: 367.50 gm at ₹0.08 per gm

   Salt Y: 301.50 gm at ₹0.40 per gm

   Each batch of Rifmn requires 30 minutes of machine time to make and the variable running costs for machine time are ₹40 per hour. The fixed production overhead cost is expected to be ₹35 per batch for the period, based on a budgeted production level of 3,00,000 batches.

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The skilled workforce who has been working on Rifmn until now are being shifted onto the production of Zutus company's new antiviral drug (injection) for Viral Disease-19 which costs millions of ₹ to develop. Zutus has obtained patent for this revolutionary drug and it is expected to save millions of lives all across the world. The launch of this drug is excitedly anticipated all over the world, while its demand in unknown and no other similar specific drug exists. The average labor cost (outsourcing) of each batch of Rifmn is ₹38.60.

The management of Zutus considers that pricing decision of Rifmn should be based on each batch.

Required

(i) CALCULATE the optimum (profit-maximizing) selling price for Rifmn and the resulting annual profit which Zutus will make from charging this price.

(ii) RECOMMEND the pricing strategy for launching of new antiviral drug.

[Note– If P = a - bQ, then MR = a - 2bQ]

Just in Time

9. X sells 'mu-50' to its customers. It purchases mu-50 from Y @ ₹ 140 per unit. Y pays all freight to X. No incoming inspection is necessary because Y has a superb reputation for delivery of quality merchandise. Annual demand of X is 13,000 units. X requires 15% annual ROI. The purchase order lead time is 2 weeks. The purchase order is passed through EDI and it costs ₹ 2 per order. The relevant insurance, material handling etc. ₹ 3.10 per unit per year. X has to decide whether or not to shift to JIT purchasing. Y agrees to deliver 100 units of mu-50→ 130 times per year (5 times every two weeks) instead of existing delivery system of 1,000 units→ 13 times a year with additional amount of ₹ 0.02 per unit. X incurs no stock out under its current purchasing policy. It is estimated X incurs stock out cost on 50 units under a JIT purchasing policy. In the event of a stock out, X has to rush order which costs ₹ 4 per unit.

Required

Briefly COMMENT whether X should implement JIT purchasing system.

10. IPL is a leading manufacturing company. Under increasing pressure to reduce costs, to control inventory level and to improve services, IPL's Costing Department has recently undertaken a decision to implement a JIT System.

The management of IPL is convinced of the benefits of their changes. But Supplies Manager "W" fears with the Costing Department's decision. He said:

"We've been driven by suppliers for years ... they would insist that we could only purchase in thousands, that we would have to wait weeks, or that they would only deliver on Mondays!"

Required

COMMENT on Mr. W's viewpoint.

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Budgetary Control

11. The following are 2 types of monthly control report of a CA firm showing gross collection (in ₹'000). The budgeted collection for the year ending on 31 March are ₹4,14,00,000 in total.

Type-X

'Gross Collection' Report for July

Activity	Budget	Most Recent Forecast for the year	Expected Variance
Accounting	16,560	17,250	690 (F)
Auditing	10,350	8,280	2,070 (A)
Taxation	14,490	13,386	1,104 (A)

Type-Y

'Gross Collection' Report for July

Activity	Monthly			Cumulative		
	Budget	Actual	Variance	Budget	Actual	Variance
Accounting	2,415	2,622	207 (F)	6,210	6,486	276 (F)
Auditing	1,380	966	414 (A)	3,450	2,691	759 (A)
Taxation	1,725	1,587	138 (A)	3,450	3,105	345 (A)

Required

IDENTIFY the type of *control system* for both types of report.

SUGGESTED ANSWERS/HINTS

1. **(i)** Michael E Porter, in 1980 in his book "Competitive strategy: Techniques' for analysing industries and competitors" suggested **five force model** to assess the *competitive environment* of an industry. The five forces which are enumerated by this model are the bargaining power of suppliers; the bargaining power of customers (buyers); the threat of new entrants; threat of substitute products; and the level of rivalry among current competitors in the industry.

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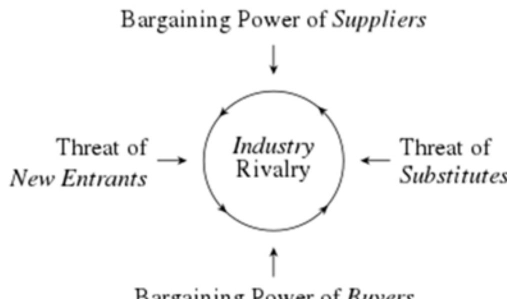

This model is also named as porter's five force analysis. Since each of these five forces *affect the competitiveness of business,* hence can be used to assess the potential of any organisation or entity; life-assurance business of SWAL (including 'sub-agency office' division) is not an exception to this.

The bargaining power of suppliers

Number of suppliers will decide the dominance they possess in term of bargaining power regarding the price of good and service they supply to business. In case of 'sub-agency office' division following factors will affect the suppliers' power–

Control over Value Chain – By adopting the strategy of forward integration the insurance companies them-selves getting into the direct sale through own network of branch offices in order to enhance their margin or reducing the margin earned by SWAL's 'sub-agency office' division. Since number of insurance companies are neither too less nor too much, hence bargaining power of insurance companies; in terms of percentage brokerage they offered to SWAL is *moderate*.

Importance of product – SWAL is also dealing in financial product's marketing and advisory, which contribute 50% of group sales and around 67% of group's profit; thus assurance business which is no doubt significant but *only choice (business) available* to SWAL. Hence, bargaining power of supplier is *moderate*.

Substitution among the brand – Life assurance product offers similar utility to client; hence easily substitutes among the brands, means if insurance company 1 charge lesser premium then insurance company 2, client will buy assurance of company 1. No doubt switching is less viable once policy subscribed. Since SWAL's 'sub-agency' division is offering the product from all 23 insurance companies, hence bargaining power of suppliers become *low*.

Supply of other factors – Other factor such 'sub-agency offices', which are largely on lease, has 30-year lease, this will reduce the lease cost as well as bargaining power of land-lord apart from bringing stability.

(Any Two Points)

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The bargaining power of customers

Whether seller is price taker or makes, this is outcome of bargaining power of customers (true sense competition). If the bargaining power is high seller will become price taker, else he is price maker. Following factors affect the bargaining power of customers of SWAL's 'sub-agency' division–

Number of buyers – In assurance industry the buyers are large (in comparison to few number of suppliers) and diversified, hence their bargaining power is *low*.

Standardised products – Since the life assurance is the product, which is standard from prospective of core functionality, hence buyers can easily substitute brands and can negotiate to reasonable extent.

Switching – Once policy subscribed can't be easily switched with another, hence due to high switching cost bargaining power reduced to some extent at-least.

(Any Two Points)

The threat of new entrants

Although entry of a new firm to the industry/ market depends upon the level of entry barriers, but if new entity enters into the industry; it will surely bring additional capacity which enhance the stiffness of competition; hence become a kind of threat. In case of 'sub-agency office' division, there are some major barriers to entry–

Less number of new life-assurance licenses by regulator due to tough regulations – As mentioned in the case that after considering the default by few insurance firms and increasing customer complaints, regulator of insurance business in country has tighten the registration criteria and harden the norms; hence this may act as entry barrier and reduce the threat of new entrants.

Less number of new insurance agent due to no new authorisation by insurance companies – As market is revamping, the agents is becoming competitor to the insurance companies and as mentioned insurance companies stopped authorising new insurance agents, hence this will act an entry barrier for new insurance agents, which is a great positive for SWAL's 'sub-agency office' division and intact the competitive advantage.

Learning curve and economies of scale – Since all the 23 insurance companies dealing in life assurance and SWAL are 10 to 20 years old organisations; hence learning curve and economies of scale (shared services for the 580 offices - presence in 580 cities) which they are enjoying may become entry barriers for new firm. Since new firms require huge capital to be at par to such learning curve and economies of scale.

(Any Two Points)

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Threat of substitution

Substitution means the product from some other industry which can render the same function which life assurance is rending. The threat of substitute product is *quiet low*.

Competitive rivalry

The level of competition among the players to acquire or retain the market share directly affects the profitability in an industry. Following factor is affecting the competitive rivalry–

Number of competitors and respective market size – Since there are good number of competitors, hence competition will be intense; may cut throat rivalry. Presently SWAL's insurance business represent 14.55% of market share (in 2019-20) in comparison to 14.29% of market share five year ago, without any major variation, hence possibility of gaining new market share is limited that too at high cost (in form of advertisement and more after sale services).

Lack of differentiation – Standardise product results in high rivalry, since the life assurance is standard product hence rivalry may be high on account of easy substitution effect among the different brands.

Slow market growth – If market is growing at high rate, rivalry may be stiffer or may be moderate; because everyone has reasonable opportunity to grow. The moment growth stagnated rivalry become stiffer because no one wish to lose market share. The industry life cycle curve is flatter here, because during last four years overall industry wide CAGR (compounded annual growth rate) of life assurance business is 3.39%, whereas year-on-year growth from 2018-19 to 2019-20 is 1.91%. Although potential is limited, but competition is still high.

Exit barriers – If the exit cost for player to move out of industry is high, it will have to be in industry and fight for survival, which may make competition tougher. Since agency agreement and lease agreement is already signed by SWAL hence, it becomes difficult to exit from the business, hence need to participate in competition to retain the share.

(Any Two Points)

(ii) Case for holding the 'sub-agency office' division

The strategic review committee suggests that the SWAL's 'sub-agency office' division should be sold off and that SWAL shall re-position its assurance business as an online solution, but the same suggestion firstly needs to be evaluated in terms of *financial perspective* among the other criteria.

The growth in life assurance business is stagnated and industry is in maturity stage of industry life cycle. This is evident from industry size and growth in the same. During last four years overall industry wide CAGR (compound annual growth rate)

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of life assurance business is 3.39%, whereas year-on-year growth from 2018-19 to 2019-20 is 1.91%. The moment growth stagnated rivalry become stiffer because no one wish to lose market share. Hence, there is intense competition in market. In cases where market witnesses intense competition, operating efficiently is essential and reduction in cost become *key success factor*; in order to offer competitive deals to clients and retain market share.

Hence it becomes need of hour, that we review the operating processes followed at 'sub-agency offices' to check whether they are efficient or not, in order to ensure greater profitability rather thinking to sale off the entire 'sub-agency office' division.

Now, move to *financial analysis*, which suggests it is beneficial to hold back 'sub-agency' division.

Contribution to the group – Insurance business is contributing 50% of top-line of overall group revenue (and 1/3rd of bottom line), and around 86% (280/ 326) of this comes from 'sub-agency office' division and 'E-platform' division contribute only remaining 14%.

Profitability – Margins are positive. There are two major parameters to evaluate profitability further on–

- Operating profit *(EBIT/ Revenue)* – No doubt, operating profit shrink from 12.4% to 6.43% in three years' time frame. But as earlier quoted, margin is positive and secondly, there is sign of recovery as well. EBIT increased in absolute terms (from 16 to 18).
- Return on capital employed *(ROCE) [EBIT / (Equity + Long Term Debt)]* – No doubt, ROCE shrink from 15.5% to 7.69% in three years' time frame. But reduction in EBIT is not only a reason, another major reason for decline is also change in capital structure. Long term debt is increased in absolute terms (from 50 to 78).

Liquidity – Current ratio *(Current Assets / Current Liabilities)* being reasonable measure of liquidity indicates enough liquidity in 'sub-agency office' division to meets it obligation. There is minor decline from 1.367 times to 1.33 times. Component analysis of working capital can be performed for greater insight.

Gearing (Debt / Equity) – Gearing ratio depicts the financial leverage, a measure of risk. Gearing ratio no doubt increased as result of introduction of debt, from 1/3 to 1/2, but under control.

(Any Two Points)

Some *other quasi-finance* and *significant factors* relevant to the decision of sale of 'sub-agency office' division and full focus on 'E-platform' division–

Client's demography – Clients from all age groups from 20 to 60+ are clients of SWAL's assurance brokerage business. 66.56% (217/326) of revenue coming from

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clients with 50+ years of age, and 99% (215/217) out of them are associated through 'sub-agency offices', hence holding of 'sub-agency' division become essential. Secondly, clients from all age group may not find it convenient to shift to 'E-platform' 'Policy at you click' and their resistance may result in losing business. Thirdly, they have easily available substitute, because competitors also have branch offices which will give them same feel.

Resistance from employees – Out of 1,564 on-roll employees of assurance brokerage business, only 50 are associated in 'E-platform' division- 'Policy at you click', rest all in 'sub-agency office' division. If SWAL re-structure itself fully as online solution for life assurance then also can't absorb all the employees, many of them need to be retrenched. Resistance will be there in both the cases, because transferred employee may not have requisite skill set, result in poor quality of service and no job satisfaction to employee. Whereas in case of retrenched workers redundancy cost will become additional financial burden. This can be seen as exit barrier.

Legal aspect in term of pre-closure of lease - SWAL has practice to sign 30-year lease, when so ever taking and 'sub-agency office' on lease in order to reduce the lease cost and bring stability. It started the business 2 decades ago and expanded it 3 years ago and many of leases are active right now, in case of pre-closure, it may be possible to bear additional financial burden as per terms of lease agreement.

Loosing USP – 'Independence and impartial advice' with presence wide across the nation, in form of 'sub-agency offices' equipped with professionally trained sale staff headed by financial planner or advisor, where customer can take advise and discuss opinion prior to investing/ buying any insurance or financial product is USP for SWAL's assurance brokerage business. By disposing the 'sub-agency office' division this central idea, with which SWAL was established may be washed out.

(Any Two Points)

In nutshell, the life assurance market has matured in recent years, and result in low growth potential and lower profitability but still yielding positive numbers. Hence, sale of 'sub-agency' division will adversely hit the revenue as well as profitability.

IMPORTANT NOTE

- **This is a comprehensive "Case Study" covering various aspects of 'Porter's Five Forces' model. Students are required to present only two relevant points for each force properly linked with the Case. More points have been given than asked for in the requirement to "assist" students.**
- **Conceptually correct and brief explanation is sufficient for each step or point.**

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2. (i) Unplanned downtime of machine 107-10M-Bearing

Overall equipment effectiveness (OEE) is a quantitative metric for measuring the productivity of individual equipment in a manufacturing plant. According to Seiichi Nakajima who introduced OEE, it is capable to identify and measure the losses in a manufacturing process through availability rate, performance rate, and quality rate.

OEE = Availability Rate × Performance Rate × Quality Rate

Quality Rate

Particulars	Units
Output units – total count	27,216
Rejected units out of the above	272
Good units – good count (which met the quality criteria) (27,216 - 272)	26,944
Quality Rate (Good Counts / Total Counts) (26,944 units / 27,216 units) → 99.00%	

Since the quality rate is 99.00% and performance rate (105%), as well as overall equipment effectiveness (93.555%), is also given in the case; hence availability rate can be measure–

Availability Rate × 105.00% × 99.00% = **93.555%**

The **Availability rate is 90%** i.e., run time [*or* net operating time (NOT)] / planned production time [*or* net available time (NAT)]

Planned Production Time

Particulars	Time in minutes
Total possible time (9 hours × 60 minutes) [scheduled time]	540
Less: Planned down time [scheduled loss]	
Short breaks (2 breaks × 15 minutes)	30
Meal break (30 minutes)	30
Planned production time	**480**

Since the Availability rate is 90% and planned production time is 480 minutes, hence **run time shall be 432 minutes** (run time / 480 minutes = 90.00%).

Since unplanned downtime is the difference between run time and planned production time, hence **unplanned downtime of machine 107-10M-Bearing is 48 minutes.**

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Particulars	Time in minutes
Planned production time	480
Less: Run time (actual time taken)	432
Unplanned Downtime	**48**

Note

Alternate Working Unplanned downtime = Planned production time (1 – availability rate) 480 minutes (1 - 90%) = 48 minutes

Advise–

In order to reduce the unplanned downtime, preventive maintenance shall be practiced either before or after each shift; and the **shine (out of 5S)** principle shall be adopted by the workman as part of the TPM initiative. It is expected that the time spends on preventive maintenance will be less than the current unplanned downtime of 48 minutes.

Alternate advices are also possible, provided shall be valid and reasonably relevant.

(ii) Ideal Cycle Time to manufacture a single bearing ball

Performance rate can be computed by dividing standard time required [*or* ideal operating time] with run time. Since performance rate (105%) is given in the case and run time (432 minutes) computed above; hence the standard time required to manufacture 27,216 bearing balls is 453.6 minutes (standard time required / 432 minutes = 105.00%)

So, standard time required to manufacture a single bearing ball (i.e., ideal cycle time) is **1 (one) second** (453.6 minutes × 60 / 27,216 balls) i.e., 60 bearing balls per minute.

Note

Alternate Working OEE = (Good count × Ideal cycle time) / Planned production time 93.555% = (26,944 × Ideal cycle time) / 480 minutes Ideal cycle time = 1 second per bearing ball

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(iii) Goldratt's five steps to remove the bottleneck at Ludhiana plant of SBBL

Goldratt's theory of constraints describes the following mentioned five steps process of identifying and taking steps to remove the bottlenecks that restrict output.

1. **Identifying the System Bottlenecks,** likewise, at unit 3 of Ludhiana plant of SBBL, 107-10M-Bearing is limiting factor hence activity performed through/using this equipment is bottleneck activity.
2. **Exploit the Bottlenecks –** Limiting factor **(**Bottleneck's activity capacity) must be fully utilised and that too optimally. Currently the overall equipment effectiveness is already 93.555%, attention on the possibility to enhance the same is needful. (Like preventive maintenance shall be practiced to avoid unplanned downtime. Similarly for each production units, way-out depends upon the limiting factor of that unit.)
3. **Non-bottleneck activities are subordinate –** Bottleneck activity should set up the pace for non-bottleneck activities. Production units shall plan their production keeping respective limiting factors at the centre point, because even if the efficiency of non-bottleneck enhanced; same may be worthless due to scarcity of limiting factor (bottleneck activity).
4. **Elevate the bottleneck –** Eliminate the bottleneck by enhancing the capacity and efficiency. Major change (business reengineering) or continuous minor change (kaizen) may do.

   Note – There will always be one bottleneck in the system, if such bottleneck is eliminated then a new constraint emerges as a bottleneck. Hence this process continuous. Ultimately improvement is a never-ending continues process.
5. **Repeat the process –** Apply step 1 to new bottleneck activity which emerges at different production units of Ludhiana plant of SBBL and repeat the process.

For Your Understanding

Seiichi Nakajima led the introduction of TPM, OEE and the Six Big Losses in the early 1970s while at the Japanese Institute of Plant Maintenance. OEE is a quantitative metric for measuring productivity of individual equipment in a manufacturing plant. OEE identifies and measures losses of crucial parts in a manufacturing process namely availability rate, performance rate and quality rate.

OEE = Availability × Performance × Quality

OEE Factors are calculated as follows–

1. Availability: NOT / NAT = (432 / 480) × 100 = 90.00%
2. Performance: IOT / NOT = (453.60 / 432) × 100 = 105.00%
3. Quality: (IOT – LOT) / IOT = (453.60 – 4.533….) / 453.60 × 100 = 99.00…%

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Or

$$\left\{\frac{27{,}216 \text{ units - } 272 \text{ units}}{27{,}216 \text{ units}}\right\}\times 100$$

OEE = A × P × Q = 90.00% × 105.00% × 99.00…% = **93.555…%**

Alternative Presentation-I

Good Counts = 27,216-272 = 26,944 units

Planned Production Time= 540 mins. – 60 mins. = 480 mins. (or NAT)

OEE = (Good Counts × Ideal Cycle Time)/ Planned Production Time

{(26,944 / 60 units (per min.)} / 480) x 100 = **93.555…%**

Alternative Presentation-II

OEE = (Ideal operating time –loss operating time)/ Net Available Time

{(453.60 – 4.533….)/ 480} × 100 = **93.555…%**

Workings

1. Scheduled Time (total time) = 540 Minutes (9hrs. × 60 mins.)
2. Planned Down Time = 2 short breaks × 15 minutes +meal break 30 minutes = 60 minutes
3. Net Available Time (NAT) = 540 – 60 = 480 minutes
4. Unplanned Downtime = 48 minutes
5. Net Operating Time (NOT) = Net Available Time – Unplanned Downtime
   NOT = 480 – 48 = 432 minutes
6. Ideal Operating Time (IOT): 27,216 total units / 60 (units per min.) = 27,216 / 60 = 453.60 minutes
7. Lost Operating Time (LOT): 272 units / 60 (units per min.) = 272 / 60 = 4.533… minutes

3. (i)

Sheetal Paper Mart
Environmental Cost Statement

Particulars	H1		H2	
	Amount (in lakhs)	% to total	Amount (in lakhs)	% to total
Environmental Prevention Costs				
Creating Environment policies [(6/2) × 0.8] [(6/2) × 1.1]	2.4	0.68	3.3	0.96
Investment in protective equipment [(7,725 – 65) – 7,620]	-	-	40#	11.58
Sub-Total (a)	**2.4**	**0.68**	**43.3**	**12.54**
Environmental Detection Costs				
Monitoring (78 in the ratio of 1:2)	26	7.40	52	15.06
Performing Contamination test	-	-	4	1.16

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Environmental Audit [1 × 8] [2 × 8]	8	2.28	16	4.63
Sub-Total (b)	**34**	**9.68**	**72**	**20.85**
Environmental Internal Failure Costs				
Recycling Scrap (275 in the ratio of 3:2)	165	46.95	110	31.86
Disposing of Toxic Material	150	42.69	120	34.75
Sub-Total (c)	**315**	**89.64**	**230**	**66.61**
Grand Total (a + b + c)	**351.4**	**100**	**345.3**	**100**

 # Since the details regarding useful economic life of the newly erected plant and the machine is not given, hence the entire incremental cost recognised in H2 only (when put to use); despite the benefit will arise over the useful economic life in form of a reduction in generation of waste.

Concept Insight

Hansen and Mendoza in the year 1999 point out that environmental costs are incurred because of poor quality controls. They classify the environmental cost into the following four categories–

- **Environmental Prevention Costs–** Those costs associated with *preventing* adverse environmental impacts.
- **Environmental Appraisal Costs–** The cost of activities executed to determine whether products, process and activities are in *compliance* with environmental standards, policies and laws.
- **Environmental Internal Failure Costs–** Costs incurred from activities that have been produced but *not discharged* into the environment.
- **Environmental External Failure Costs–** Costs incurred on activities performed *after discharging* waste into the environment.

(ii) Analysis

The environmental cost incurred in H2 (₹345.3 lakhs) is comparatively less than what was incurred in H1 (₹351.4 lakhs). Environmental internal failure costs reduced in H2 (₹230 lakhs) in comparison to H1 (₹315 lakhs), but still a substantial component of total environmental costs (66.61% in H2 against 89.64% in H1). The reduction of environmental internal failure costs is the outcome of increased environmental prevention costs (12.54% in H2 against 0.68% in H1) and environmental detection costs (20.85% in H2 against 9.68% in H1).

Note – *Since the policy document also states 'zero discharge of waste/scrap into the environment, in order to be true-sense eco-friendly enterprise' hence there are no* ***environmental external failure costs.***

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(iii) Evaluation

Apart from getting the certificate, the cross-functional team has terms of reference *'**to improve the environmental impact** & **image of SPM as eco-friendly enterprise** and **control environmental cost**'*

In the context of **controlling environmental cost**, the team attained a reasonable reduction in total environmental cost, impact in this environmental cost statement (over H1 and H2) seem low because the incremental cost due to purchase of premium version of plant and machine is charged in H2, which will benefit in form reduced waste over the useful economic life.

In the context of **improving the image of SPM as an eco-friendly enterprise**, the policy document which in practice also states– *'zero discharge of waste/scrap into the environment, in order to be true-sense eco-friendly enterprise'* and same is also visible through environmental cost statement as there are no environmental external failure costs

In the context of **improving the environmental impact**, SPM able to generate low waste in H2 (2,000 MT) in comparison of H1 (3,000 MT) just by installing new plant and machine which produce less waste, increased monitoring, and audits.

Hence it can be concluded that the team is successfully serving the terms of reference.

4. (i) Cellular manufacturing is a lean way to enhance productivity by improving (reducing) the performance in the context of *time* and *motion* involved in the production.

Cellular manufacturing is an application of **group technology** in the manufacturing in which all or a portion of a firm's manufacturing system has been converted into **manufacturing cells**.

Here is important to note that a manufacturing cell is a cluster of machines or processes located in close proximity and dedicated to the manufacturing of a family of parts.

Cellular Manufacturing results in following benefits to improve productivity–

(a) Reduce setup times by using part family tooling and sequencing.

(b) Reduce flow times by reducing material handling and transit time and using smaller batch sizes (even single piece flow – this also results in the requirement of less floor space).

(c) Reduce lead time.

(d) Reduced work-in-process inventory.

(e) Better use of human resources. Hence, reduced direct labour but heightened sense of employee participation.

(f) Better scheduling, easier to control, and automate.

(g) Increased use of equipment & machinery, hence reduced investment on machinery & equipment.

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Hence, concern expressed by Mr. Mishra, regarding the utility of cellular manufacturing to enhance productivity is not material.

(ii) The Machine Cell Design can be classified based on the number of machines and the degree to which the material flow is mechanized between the machines. The most common designs are–

(a) **Single Machine Cell** consists of a machine plus supporting fixtures and tooling to make one or more part families. This can be applied **(useful)** to work parts that are made by one type of process such as turning or milling.

(b) **Group Machine Cell with manual handling** consists of more than one machine used collectively to one or more part families and no provision for mechanical part movement between machines. In this, human operators run the cell and perform material handling.

Note– *If the size of the part is huge or there is a large number of machines in the cell, then regular handling crew may be required.*

Preferable cell shape is ***U-shaped*** *(single/few workers). U shape is useful in the movement of multi-functional workers.*

Since the design simply includes certain machines in the group and restrict their use for specified part family hence often achieved without rearranging the process type layout; So, bring the cost-saving (on rearranging) but lock-in material handling benefits of group technology.

(c) **Group Machine Cell with semi-integrated handling** consists of more than one machine used collectively to one or more-part families and uses a mechanical handling system, such as conveyor, to move parts between machines in the cell.

Note– *There may be* ***in-line layout*** *(identical or similar routing - machines are laid along a conveyor to match the processing sequence) and* ***loop layout*** *(allows parts to circulate in the handling system and permits different processing steps in the different parts in the system).*

(d) **Flexible Manufacturing System** is a highly automated machine cell in group technology that combines automated processing stations with a fully integrated material handling system.

(iii) **Rank Order Clustering Algorithm** to form machine-part groups–

Assign **Binary Weight** ($BW_j = 2^{n-j}$) to each column *j* of the matrix, where $n = 5$ (the number/ types of components). Calculate the **Decimal Equivalent** (DE_i) of the binary values of each row *i* using the formula:

$$DE_i = \sum_{j=1}^{n} (BW_j)(a_{ij})$$

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Rank the rows in decreasing order of their DE_i values i.e., the largest value is ranked as 1.

j / i	P101	P104	P105	P107	P108	DE_i	Rank
M2	1					**16**	**2**
M7		1			1	**9**	**4**
M13	1			1		**18**	**1**
M13A		1	1			**12**	**3**
M15				1		**2**	**5**
BW_j	**2^{5-1} =**	**2^{5-2} =**	**2^{5-3} =**	**2^{5-4} =**	**2^{5-5} =**		
	16	**8**	**4**	**2**	**1**		

Now, **Re-arrange** the rows in the running order of the rankings.

Since further rearrangement is necessary, assign **Binary Weight** ($BW_i = 2^{m-i}$) to each row i of the matrix, where m =5 (the number of machines). Calculate the **Decimal Equivalent** (DE_j) of the binary values of each column j using the formula:

$$DE_j = \sum_{i=1}^{m} (BW_i)(a_{ij})$$

Rank the columns in decreasing order of their DE_j values i.e., the largest value is ranked as 1.

j / i	P101	P104	P105	P107	P108	BW_i	
M13	1			1		**2^{5-1}=**	**16**
M2	1					**2^{5-2}=**	**8**
M13A		1	1			**2^{5-3}=**	**4**
M7		1			1	**2^{5-4}=**	**2**
M15				1		**2^{5-5}=**	**1**
DE_j	**24**	**6**	**4**	**17**	**2**		
Rank	**1**	**3**	**4**	**2**	**5**		

Now, **Re-arrange** the columns in the running order of the rankings.

Since further rearrangement is necessary, assign **Binary Weight** ($BW_j = 2^{n-j}$) to each column j of the matrix, where $n = 5$. Calculate the **Decimal Equivalent** (DE_i) of the binary values of each row i using the formula:

$$DE_i = \sum_{j=1}^{n} (BW_j)(a_{ij})$$

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Rank the rows in decreasing order of their DE_i values.

j / i	P101	P107	P104	P105	P108	DE_i	Rank
M13	1	1				**24**	**1**
M2	1					**16**	**2**
M13A			1	1		**6**	**4**
M7			1		1	**5**	**5**
M15		1				**8**	**3**
BW_j	**2^{5-1} =**	**2^{5-2} =**	**2^{5-3} =**	**2^{5-4} =**	**2^{5-5} =**		
	16	**8**	**4**	**2**	**1**		

Now, **Re-arrange** the rows in the running order of the rankings.

Since further rearrangement is necessary, assign **Binary Weight** ($BW_i = 2^{m-i}$) to each row *i* of the matrix, where m =5. Calculate the **Decimal Equivalent** (DE_j) of the binary values of each column *j* using the formula:

$$DE_j = \sum_{i=1}^{m} (BW_i)(a_{ij})$$

Rank the columns in decreasing order of their DE_j values.

j / i	P101	P107	P104	P105	P108	BW_i	
M13	1	1				**2^{5-1}=**	**16**
M2	1					**2^{5-2}=**	**8**
M15		1				**2^{5-3}=**	**4**
M13A			1	1		**2^{5-4}=**	**2**
M7			1		1	**2^{5-5}=**	**1**
DE_j	**24**	**20**	**3**	**2**	**1**		
Rank	**1**	**2**	**3**	**4**	**5**		

Since the ranking is now neatly arranged in order, stop the process. We can now identify the groupings.

Part Families and Machine Groups

Cluster/Cell	Part	Machine
I	P101 and P107	M13, M2, and M15
II	P104, P105, and P108	M13A and M7

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Concept Insight

1. **Production Flow Analysis** rests on the basic idea to identify items that are made with the same processes / the same set of equipment. These parts are assembled into a part family and such the same equipment can be grouped (clustering) into a cell to minimize material handling requirements.

Clustering Methods

- **Part family grouping -** Form part families and then group machines into cells
- **Machine grouping -** Form machine cells based upon similarities in part routing and then allocate parts to cells
- **Machine-part grouping -** Form part families and machine cells simultaneously.

Note - The machine-part grouping is most significant.

2. Various **heuristic and exact methods** have been developed for grouping/clustering, but the simplest one is **binary ordering**, also known as **rank order clustering** or **King's algorithm.**
3. **Rank Order Clustering Algorithm** is a simple algorithm used to form machine-part groups.

Rank Order Clustering Algorithm

The steps in using the Rank Order Clustering Algorithm are as follows:

1. Assign **Binary Weight** ($BW_j = 2^{n-j}$) to each column *j* of the matrix, where *n is* the number/ types of components (parts).
2. Calculate the **Decimal Equivalent** (DE_i) of the binary values of each row *i* using the formula:

$$DE_i = \sum_{j=1}^{n} (BW_j)(a_{ij})$$

3. **Rank** the rows in decreasing order of their DE_i values i.e., the largest value is ranked as 1. Break ties (if any) arbitrarily.
4. **Re-arrange** the rows in the running order of the rankings.
5. If no further rearrangement is necessary, stop. Otherwise, go to next step i.e.,6.
6. Assign **Binary Weight** ($BW_i = 2^{m-i}$) to each rearranged row *i* of the matrix, where m is the number of machines.
7. Calculate the **Decimal Equivalent** (DE_j) of the binary values of each column *j* using the formula:

$$DE_j = \sum_{i=1}^{m} (BW_i)(a_{ij})$$

8. **Rank** the columns in decreasing order of their DE_j values i.e., the largest value is ranked as 1. Break ties (if any) arbitrarily.
9. **Re-arrange** the columns in the running order of the rankings.
10. If no rearrangement is necessary, stop. Otherwise, go to step 1.

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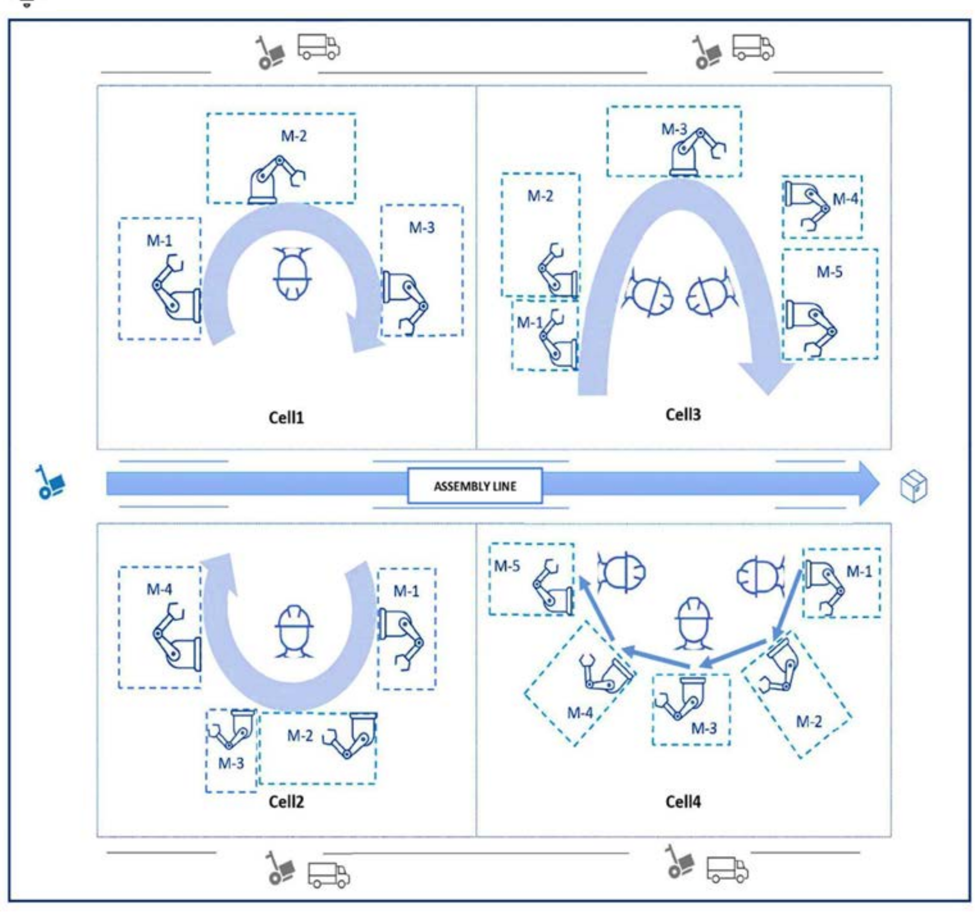
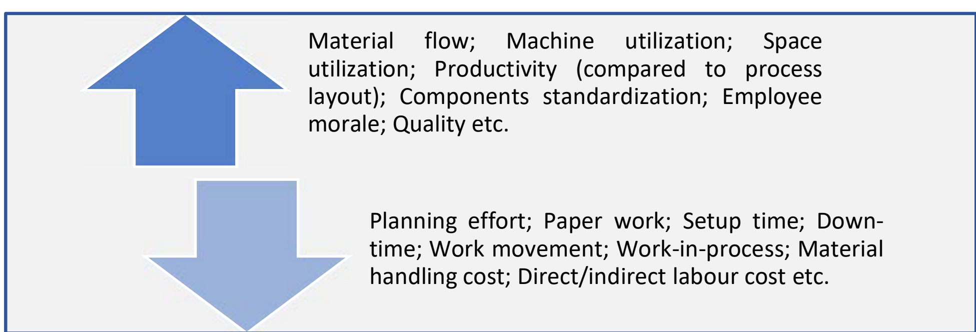
Flow Shop or Assembly Line Workflow





Note- This illustrative layout has been given to assist students to comprehend the concept of **U-Shaped** Cells with single/ few workers.

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5. Assign **Binary Weight** ($BW_j = 2^{n-j}$) to each column j of the matrix, where n =6 (the number/ types of parts). Calculate the **Decimal Equivalent** (DE_i) of the binary values of each row i using the formula:

$$DE_i = \sum_{j=1}^{n} (BW_j)(a_{ij})$$

Rank the rows in decreasing order of their DE_i values i.e., the largest value is ranked as 1.

i \ j	P_1	P_2	P_3	P_4	P_5	P_6	DE_i	Rank
M_b			1		1		**10**	**4**
M_c				1	1	1	**7**	**5**
M_d	1	1					**48**	**2**
M_e			1		1	1	**11**	**3**
M_f	1	1		1			**52**	**1**
BW_j	2^{6-1} = **32**	2^{6-2} = **16**	2^{6-3} = **8**	2^{6-4} = **4**	2^{6-5} = **2**	2^{6-6} = 1		

Now, **Re-arrange** the rows in the running order of the rankings.

Since further rearrangement is necessary, assign **Binary Weight** ($BW_i = 2^{m-i}$) to each row i of the matrix, where m =5 (the number of machines). Calculate the **Decimal Equivalent** (DE_j) of the binary values of each column j using the formula:

$$DE_j = \sum_{i=1}^{m} (BW_i)(a_{ij})$$

Rank the columns in decreasing order of their DE_j values i.e., the largest value is ranked as 1. [Break ties arbitrarily]

i \ j	P_1	P_2	P_3	P_4	P_5	P_6	BW_i	
M_f	1	1		1			2^{5-1}=	16
M_d	1	1					2^{5-2}=	8
M_e			1		1	1	2^{5-3}=	4
M_b			1		1		2^{5-4}=	2
M_c				1	1	1	2^{5-5}=	1
DE_j	**24**	**24**	**6**	**17**	**7**	**5**		
Rank	**1**	**2**	**5**	**3**	**4**	**6**		

Now, **Re-arrange** the columns in the running order of the rankings.

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Since further rearrangement is necessary, assign **Binary Weight** ($BW_j = 2^{n-j}$) to each column *j* of the matrix, where *n* =6. Calculate the **Decimal Equivalent** (DE_i) of the binary values of each row *i* using the formula:

$$DE_i = \sum_{j=1}^{n} (BW_j)(a_{ij})$$

Rank the rows in decreasing order of their DE_i values.

i \ j	P_1	P_2	P_4	P_5	P_3	P_6	DE_i	Rank
M_f	1	1	1				56	1
M_d	1	1					48	2
M_e				1	1	1	7	4
M_b				1	1		6	5
M_c			1	1		1	13	3
BW_j	2^{6-1} =	2^{6-2} =	2^{6-3} =	2^{6-4} =	2^{6-5} =	2^{6-6} =		
	32	16	8	4	2	1		

Now, **Re-arrange** the rows in the running order of the rankings.

Since further rearrangement is necessary, assign **Binary Weight** ($BW_i = 2^{m-i}$) to each row *i* of the matrix, where m =5. Calculate the **Decimal Equivalent** (DE_j) of the binary values of each column *j* using the formula:

$$DE_j = \sum_{i=1}^{m} (BW_i)(a_{ij})$$

Rank the rows in decreasing order of their DE_j values. [Break ties arbitrarily]

i \ j	P_1	P_2	P_4	P_5	P_3	P_6	BW_i	
M_f	1	1	1				2^{5-1}=	16
M_d	1	1					2^{5-2}=	8
M_c			1	1		1	2^{5-3}=	4
M_e				1	1	1	2^{5-4}=	2
M_b				1	1		2^{5-5}=	1
DE_j	24	24	20	7	3	6		
Rank	1	2	3	4	6	5		

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Now, **Re-arrange** the columns in the running order of the rankings.

Since further rearrangement is necessary, assign **Binary Weight** ($BW_j = 2^{n-j}$) to each column *j* of the matrix, where *n* =6. Calculate the **Decimal Equivalent** (DE_i) of the binary values of each row *i* using the formula:

$$DE_i = \sum_{j=1}^{n} (BW_j)(a_{ij})$$

Rank the rows in decreasing order of their DE_i values.

i \ j	P_1	P_2	P_4	P_5	P_6	P_3	DE_i	Rank
M_f	1	1	1				56	1
M_d	1	1					48	2
M_c			1	1	1		14	3
M_e				1	1	1	7	4
M_b				1		1	5	5
BW_j	2^{6-1} =	2^{6-2} =	2^{6-3} =	2^{6-4} =	2^{6-5} =	2^{6-6} =		
	32	16	8	4	2	1		

Since the ranking is now neatly arranged in order, stop the process. We can now identify the cells.

Cell1	P_1, P_2, P_4	M_f, M_d
Cell2	P_5, P_6, P_3	M_c, M_e, M_b

The following cells, as derived from the Rank Order Clustering Algorithm, shall be presented to Mr. Gupta for consideration along with the below comments.

Cell1		Cell 2	
Part Family 1	**Machine Group 1**	**Part Family 2**	**Machine Group 2**
P_1	M_f	P_5	M_c
P_2	M_d	P_6	M_e
P_4		P_3	M_b

Comments

It is essential to understand that the cells are ***not totally independent***. Since P_4, which is member of cell1, needs processing in M_c. But machine M_c belongs to cell 2. So, some amount of intercell movement/ change will take place in this situation. In general, these moves may become unavoidable in real life circumstances. There are various alternative ways of eliminating intercell moves in a cellular manufacturing system like– redesigning the part so that the machine belongs to other cell is no longer required for processing, subcontracting the part/ adding the necessary machines in the cell. The cell designer should evaluate the consequences of each of these ways and take suitable measures/ ways to minimise these moves.

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6. (i) Batch Inspection Time and Batch Move Time

It is given in the question that currently–

MCE is 62.50%,

Batch process time is 20 days, and

Batch queue time is 6 days.

Let presume batch move time 'x' then batch inspection time will be '2x' because currently double then batch move time.

Hence,

$$62.50\% \; or \; 0.6250 = \frac{20 \text{ days}}{20 \text{ days} + x + 2x + 6 \text{ days}}$$

Solving linear equation

$\Rightarrow 20 \text{ days} + x + 2x + 6 \text{ days} = \frac{20 \text{ days}}{.6250}$

$\Rightarrow 20 \text{ days} + x + 2x + 6 \text{ days} = 32 \text{ days}$

$\Rightarrow 3x + 26 \text{ days} = 32 \text{ days}$

$\Rightarrow 3x = 32 \text{ days} - 26 \text{ days}$

$\Rightarrow 3x = 6 \text{ days}$

$\Rightarrow x = 2 \text{ days}$

So, **Batch move time** (x) is 2 days and **Batch inspection time** (2x) is 4 days

(ii) Manufacturing Cycle Time and Non-Value-Added Time (in days)

$$62.50\% \text{ or } .6250 = \frac{20 \text{ days}}{\text{Manufacturing cycle time}}$$

$\Rightarrow \text{Manufacturing cycle time} = \frac{20 \text{ days}}{.6250}$

$\Rightarrow \text{Manufacturing cycle time} = 32 \text{ days}$

Or

Manufacturing cycle time includes all form of time a product spends (in manufacturing department).

Hence, Manufacturing cycle time = 20 days + 2 days + 4 days + 6 days = 32 days

Non-Value Added Time is that component of manufacturing cycle time which does not lead to any value creation directly.

Hence, Non-value added time = 32 days – 20 days i.e., 12 days

Or

2 days + 4 days + 6 days = 12 days

Note – if the discussion is regarding **customer response time** then non-value added time also includes wait time before the order getting processed.

(iii) **Revised Manufacturing Cycle Efficiency** if both batch inspection time and batch move time cut down to half of the current level and other elements remains constant.

Hence,

Batch process time is 20 days,

Batch queue time is 6 days,

Revised batch move time is **1 day** (half of 2) and

Revised batch inspection time is **2 days** (half of 4).

$$\text{MCE}_{\text{Revised}} = \frac{20 \text{ days}}{20 \text{ days} + 1 \text{ day} + 2 \text{ days} + 6 \text{ days}}$$

$$\Rightarrow \text{MCE}_{\text{Revised}} = \frac{20 \text{ days}}{29 \text{ days}}$$

$$\Rightarrow \text{MCE}_{\text{Revised}} = .6897 \text{ or } 68.97\%$$

Improvement is recorded from 62.50% to 68.97%, on account of cut down of batch inspection time and batch move time to half of current level.

(iv) **Cellular manufacturing** capable to reduce motions on the production floor. Cellular manufacturing is a **lean way** to enhance productivity by improving the performance in the context of time and motion involved in the production.

Cellular manufacturing is an application of **group technology** in manufacturing in which all or a portion of a firm's manufacturing system has been converted into **manufacturing cells** (a cluster of machines or processes located in close proximity and dedicated to the manufacturing of a family of parts). In this manner cellular manufacturing results in the reduction of move time by reducing material handling (through integrated cell) and transit time and using smaller batch sizes (even single unit).

Hence motion (movement) of material (& product) and worker on production is reduced on the production floor. This may also result in reduced queue time because batch size is small even single piece flow in some cases. This is beneficial to the worker as well in two ways, apart from enhancing the productivity for organisation; first, due to **less motion, fatigue will also be less** to the worker after working in a shift of the same tenure (if he is a piece-rate worker get more wages) and second since he is working on more than one machine and part hence may feel **more empowered**. So cellular manufacturing leads to win-win situation wherein organisation benefits reduced direct labour cost and the worker has heightened sense of participation.

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7. (i) **Demand function**

b = change in price/change in quantity b = ₹4/8,000 units = 0.0005

The maximum demand for Rifmn is 10,00,000 units, so where P = 0, Q = 10,00,000, so 'a' is established by substituting these values for P and Q into the demand function:

0 = a – (0.0005 × 10,00,000)

0 = a – 500

Therefore,

a = 500

Demand function is therefore: P = 500 – 0.0005Q

Marginal cost

		Total ₹
Salt X	367.50g × ₹0.08	29.40
Salt Y	301.50g × ₹0.40	120.60
Labour	Given in ques	38.60
Machine running cost	(30/60 × ₹40.00)	20
Total marginal cost per batch		208.60

Marginal revenue function: MR = a – 2bQ

Equate MC and MR and insert the values for 'a' and 'b' from the demand function in step 1

⇒ 208.60 = 500 – (2 × 0.0005 × Q)

Solve the MR function (to determine optimum quantity, Q)

⇒ 208.60 = 500 – 0.001Q

⇒ 0.001Q = 291.4

⇒ Q = 291,400 batches

Calculate the optimum price

⇒ P = 500 – (0.0005 × 291,400)

⇒ P = ₹354.30

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Calculate Profit

	₹
Revenue (2,91,400 batches × ₹354.3)	10,32,43,020
Less: Variable costs (2,91,400 batches × ₹208.60)	6,07,86,040
Less: Fixed costs (3,00,000 batches × ₹35)	1,05,00,000
Profit	3,19,56,980

(ii) Firms often use different pricing strategies when their products are first launched into the market. The most two common approaches are price skimming and penetration pricing.

In ***penetration pricing***, low price is charged initially, thought behind this is that low price will make the product accessible to large number of buyers, so high sales will compensate the low price being charged getting the benefits of economy of scale. This approach works best when customers are *price sensitive*, R & D and marketing expenses are low, or when competitors will quickly enter the market.

In this case, medicines are *highly inelastic* in nature so any reduction in price will not increase the demand of the drug, which clearly indicates that market penetration pricing will not help.

Skimming Pricing refers to charging high price initially than lower the prices. High price in the early stage of the product's life cycle is expected to generate high initial cash flows, which will help the company to recover high development cost. This would enable the company to take advantage of unique nature of the product.

In present case, the unique nature of drug, entry barrier (since company has taken patent) requires huge initial investment and considering this market skimming pricing strategy would be more favorable pricing strategy. However, this strategy only works as long as drug is protected by patent.

In addition, a drug firm is required to consider the expected reactions from national price controllers who in turn may be influenced by political factors and public opinion.

Practical Insight

Most of the people in developing countries buy medicines through out-of-pocket payments, high prices of medicines might force people to forego treatment or go into debt. As a result, price of the medicines may be regulated by the health organisations/ agencies.

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8. (i) The loss in case of temporary discontinue is ₹185 lakhs which is less than the loss in case of continuing the production of CVS (i.e., ₹250 lakhs), hence **considering monetary aspects** it is advised to discontinue (lock-out) the production of CSV for the first half of the fiscal year 2020-21.

Comparative Cost and Benefit for the first half of the fiscal year 2020-21

Continue – 40,000 units		Dis-continue (Lock-out)	
Particulars	**Amount in ₹**	**Particulars**	**Amount in ₹**
Contribution (₹500×40,000units)	200 Lakhs	Additional Cost (resumption)	35 Lakhs
Fixed Cost	450 Lakhs	Fixed Cost (unavoidable)	150 Lakhs
Loss	**250 Lakhs**	**Cost**	**185 lakhs**

Working note 1 – Contribution *per unit*

Particulars	Amount in ₹
Sale Price	1,600
Variable Cost (575+215+310)	1,100
Contribution	500

Working note 2 – Fixed Cost & Avoidable Component

Particulars	Amount in ₹
Total Fixed Cost for the first half [(75,000×2) units ×300]	450 Lakhs
Unavoidable (1/3rd)	150 Lakhs
Balance - Avoidable (2/3rd)	300 Lakhs

(ii) Qualitative factors, while deciding either discontinue (lock-out) or continue.

(a) Government advisory regarding lock-down and lock-in – MGIL is legally bound to observe and comply with government advisories regarding lock-down and lock-in.

(b) Customer relations – Discontinuing the production, even temporary may cause adverse reactions from customers, they may move to another product or brand which capable to substitute CVS. Further as per the director's opinion old stock will be cleared during such period, this may cause a *loss of reputation*.

(c) Supplier relations – The trade relation with suppliers of VSD/MGIL may turn bitter if supply halted. May also cause a loss of goodwill. Although the director argued that supplier can sell the old stock available with them, but it is nowhere mentioned that whether all the supplier or retailer have a *requisite amount of stock* in order to cater the need of their customers.

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(d) **Employee/Worker relations** – One of the directors mentioned that migrant workers moved to their home states and expected to come back in 3-5 months. It is important to identify– *how much of the workforce* at VSD is migrant and *what is the duration of lock-down* announced by the government, is there any relaxation in the same (for example working with 1/3 or 1/2 capacity)? VSD also need to consider *guideline and term of the agreement with workers*, in regard to the compensation they will get, if it is decided to lock-out (temporarily discontinue the production). Apart from this, staff (or workers) morale is also an important factor to consider.

(e) **Timing of shutdown** – Timing (when to lock and unlock) and duration of lock-out, both are important form preview of VSD, because the kind of product in which MGIL deals either in demand during the *relevant season* or *near festival season* (during sales and bonanzas).

(f) **Whether discontinuing a segment have adverse effects on the sale of other products** – CVS is a *complementary product* to other models sold by VDS and product sold by MGIL. Hence, impact of discontinuing the production of CVS on sale of these relate products need to be considered.

(iii) In order to economically justify the decision of continuing the production, VSD need to manufacture and sell such number of CVS; so that loss (if continued) shall be less than or equal to the loss/ cost of ₹185 lakhs (which is due to discontinue (lock-out) of plant for the first half of fiscal 2020-21).

So, let presume 'x' is such number of CSV

450 Lakhs – (₹ 500 × 'x') ≤ 185 Lakhs

⇒ 500x ≥ 265 Lakhs

x ≥ 53,000 Units

Hence, VSD need to manufacture and sell at least 53,000 units of CVS; in order to economically justify the continuation of the production.

9. **Comparative 'Statement of Cost' *for* Purchasing from Y under 'Current Policy' & 'JIT'**

Particulars	Current Policy (₹)	JIT (₹)
Purchasing Cost	18,20,000 (13,000 units × ₹140)	18,20,260 (13,000 units × ₹140.02)
Ordering Cost	26.00 (₹2 × 13 Orders)	260.00 (₹2 ×130 Orders)

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Particulars	Current Policy (₹)	JIT (₹)
Opportunity / Carrying Cost	10,500.00 (1/2 × 1,000 units × ₹140 × 15%)	1,050 (1/2 × 100 units × ₹ 140.02 × 15%)
Other Carrying Cost (Insurance, Material Handling etc)	1,550.00 (1/2 × 1,000 units × ₹3.10)	155.00 (1/2 × 100 units × ₹3.10)
Stock Out Cost	---	200 (50 units × ₹4.00)
Total Relevant Cost	**18,32,076**	**18,21,925**

Comments

As may be seen from above, the relevant cost under the JIT purchasing policy is lower than the cost incurred under the existing system. Hence, a JIT purchasing policy should be adopted by the company.

10. *"For successful operation of JIT inventory system, the suppliers chosen must be willing to make frequent deliveries in small lots. Rather than deliver a week's or a month's material at one time, suppliers must be willing to make deliveries several times a day and in the exact quantities specified by the buyer."*

It is described in the problem that suppliers are not willing to

- make frequent deliveries and
- make supplies in the exact quantities as required.

Accordingly Mr. W's doubt is correct on successful implementation of JIT System.

11. Type-X indicates to a feedforward control system. A feedforward control system operates by comparing budgeted results against a forecast. So that, corrective action can be taken to avoid expected adverse variances.

Type-X

'Gross Collection' Report for July

Activity	Budget	Most Recent Forecast for the year	Expected Variance
Accounting	16,560	17,250	690 (F)
Auditing	10,350	8,280	2,070 (A)
Taxation	14,490	13,386	1,104 (A)
Total	**41,400**	38,916	2,484 (A)

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Type-Y reveals feedback control system. A feedback control system identifies variances that has already taken place, by comparing the actual historical results with the budgeted results.

Type-Y

'Gross Collection' Report for July

Activity	Monthly			Cumulative		
	Budget	Actual	Variance	Budget	Actual	Variance
Accounting	2,415	2,622	207 (F)	6,210	6,486	276 (F)
Auditing	1,380	966	414 (A)	3,450	2,691	759 (A)
Taxation	1,725	1,587	138 (A)	3,450	3,105	345 (A)
Total	5520	5175	345 (A)	13110	12282	828 (A)

Note- *Both Feedback and Feedforward Controls may coexist in the same system, but the two designs function in very different ways.*

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PAPER 7: DIRECT TAX LAWS & INTERNATIONAL TAXATION

The November, 2020 edition of the Study Material, based on the provisions of direct tax laws, as amended by the Finance Act, 2020, the Taxation and Other Laws (Relaxation and Amendment of Certain Provisions) Act, 2020 and significant notifications issued upto 31.10.2020, is relevant for May, 2021 examinations. The relevant assessment year for May, 2021 examination is A.Y.2021-22.

QUESTIONS AND ANSWERS

Case Scenario 1

Mr. Rajesh, aged 53 years, and his wife Mrs. Sowmya, aged 50 years, were born in India. They were living in India till the year 2000, when they moved to Country X and settled there permanently. Since the year 2010, they have become citizens of Country X. They have two sons who are twins, Mr. Dinesh and Mr. Karthik, who are also citizens of Country X. They completed their schooling in an Indian school in Country X. Thereafter, in the year 2015, Mr. Dinesh joined mechanical engineering in IIT Delhi. After completing his engineering, he took up employment in ABC Ltd., a multinational company, in Gurgaon at a monthly salary of ₹ 1,50,000 from September, 2019. Dinesh visits his parents in Country X for one month every year. For the rest of the year, he is in India. Mr. Karthik completed architecture in College of Architecture in Country X and took up a job in LMN Inc., San Fransisco, in the year 2019 for a monthly salary of US $ 5,000. Mr. Rajesh has a textile business in Country X. Mrs. Sowmya, a Carnatic musician, gives concerts in Country X in music programs organized by the Indian community in Country X.

Mr. Rajesh visits India for one month every year to be with his parents, who were born in Coimbatore and have always lived in Coimbatore. The details of his income for P.Y.2020-21 are as follows –

Income from textile business in Country X - US $ 80,000 (You may assume that the currency of Country X is US dollars)

Rental income from house property in Coimbatore – ₹ 60,000 p.m.

Interest on fixed deposits with SBI, Coimbatore – ₹ 10 lakh

Country X does not levy tax on income from business of textiles in order to give a fillip to textile industry in that country. Country X also does not levy tax on income earned by a resident of Country X outside India.

In the P.Y.2020-21, Mrs. Sowmya visited India from 3rd October, 2020 to 31st January, 2021. She was in Trichy during the months of October and November to take care of her ailing mother in Trichy. During the months of December and January, she rendered Carnatic music concerts in the Margazhi Maha Utsav organized in the various music academies in Chennai. Every year, she is in Chennai entirely during these two months for this purpose. She also

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visits Trichy every year for the full month of May to spend time with her mother. She owns a house property in Trichy which she has let out for ₹ 40,000 per month. The municipal taxes of ₹ 6,000 p.a. are paid by her tenant. For the P.Y.2020-21, income from music concerts in Chennai is ₹ 3 lakhs. She also earns interest of ₹ 9 lakhs on fixed deposits with Indian Bank, Trichy Branch.

Mr. Dinesh resigned from his job in ABC Ltd. on 20th September, 2020 and took up an offer for employment in MNC Inc., New York at a salary of US $ 7,000 p.m. He had submitted his resignation to ABC Ltd. on 20th August, 2020, and thereafter, served a notice period of one month as per the condition stipulated in his terms of employment. He left India on 28th September, 2020 and joined MNC Inc. on 1st October, 2020. He earned interest of ₹ 40,000 from fixed deposits with Axis Bank, New Delhi.

Mr. Karthik resigned from LMN Inc. on 30th November, 2020 to join PQR Ltd. in Mumbai. He came to India on 2nd December, 2020 and joined PQR Ltd. on 5th December, 2020. His salary in PQR Ltd. is ₹ 99,200 p.m. He used to visit his maternal and paternal grandparents in India for two months (July and August) during his summer holidays upto the year 2018. In the year 2019, he visited India for one month in July 2019. He earned interest of ₹ 9,500 from savings bank account in SBI, Mumbai.

TT buying rate of US $ on various dates is given below –

Date	TT buying rate of US $	Date	TT buying rate of US $
31.3.2020	₹ 68.00	30.9.2020	₹ 70.00
30.4.2020	₹ 68.60	31.10.2020	₹ 70.40
31.5.2020	₹ 69.10	30.11.2020	₹ 71.00
30.6.2020	₹ 69.50	31.12.2020	₹ 71.30
31.7.2020	₹ 69.70	31.1.2021	₹ 71.90
31.8.2020	₹ 69.90	28.2.2021	₹ 72.00
		31.3.2021	₹ 72.40

On the basis of the facts given above, choose the most appropriate answer to Q.1 to Q.5 below: Your answer should be based on the provisions of the Income-tax Act, 1961. Ignore the provisions of DTAA, if any, between India and Country X.

1. What is the residential status of Mrs. Sowmya for A.Y.2021-22?

   (a) Resident and Ordinarily resident

   (b) Resident but not ordinarily resident

   (c) Non-resident

   (d) Deemed resident

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2. What is the residential status of Mr. Dinesh and Mr. Karthik for A.Y.2021-22?
   (a) Both are non-residents
   (b) Resident and ordinarily resident & Resident but not ordinarily resident, respectively.
   (c) Non-resident & Resident but not ordinarily resident, respectively
   (d) Resident and ordinarily resident & non-resident, respectively.
3. What is the total income of Mr. Dinesh chargeable to tax under the regular provisions of the Income-tax Act, 1961 for A.Y.2021-22?
   (a) ₹ 38,93,000
   (b) ₹ 38,26,200
   (c) ₹ 8,90,000
   (d) ₹ 8,40,000.
4. What is the total income of Mr. Karthik chargeable to tax under the regular provisions of the Income-tax Act, 1961 for A.Y.2021-22?
   (a) ₹ 31,10,000
   (b) ₹ 31,34,500
   (c) ₹ 3,34,000
   (d) ₹ 3,93,500
5. What is the residential status of Mr. Rajesh for A.Y.2021-22?
   (a) Resident and ordinarily resident
   (b) Resident but not ordinarily resident
   (c) Deemed resident
   (d) Non-resident

Case Scenario 2

The following details pertain to Mr. Arvind and his three brothers, Mr. Arjun, Mr. Anand and Mr. Aakash. Mr. Arvind, Mr. Arjun and Mr. Anand are engaged in retail trade business. Mr. Aakash is engaged in the profession of interior decoration. All of them maintain books of account under section 44AA. While the brothers engaged in retail trade business follows mercantile system of accounting, Mr. Aakash engaged in interior decoration profession follows cash system of accounting. The details pertaining to their business for the year ending 31.3.2021 are as under –

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	Particulars	Mr. Arvind	Mr. Arjun	Mr. Anand
(i)	Turnover of P.Y.2020-21	₹ 95 lakhs	₹ 1.80 crore	₹ 5.00 crore
(ii)	Amount received in cash [out of (i) above]	₹ 5 lakh	₹ 8 lakh	₹ 4 lakh
(iii)	Amount received through NEFT/RTGS on or before 31.7.2021 [out of (i) above]	₹ 85 lakh	₹ 1.65 crore	₹ 4.80 crore
(iv)	Total receipts in the P.Y.2020-21	₹ 1.07 crore	₹ 2.00 crore	₹ 5.50 crore
(v)	Cash receipts [out of (iv) above]	₹ 7 lakh	₹ 10 lakhs	₹ 27 lakhs
(vi)	Total payments in the P.Y. 2020-21	₹ 80 lakhs	₹ 1.60 crore	₹ 4.50 crore
(vii)	Cash payments [out of (vi) above]	₹ 5 lakhs	₹ 8.10 lakhs	₹ 22 lakhs
(viii)	Profits and gains as per books of account u/s 44AA	₹ 5.90 lakhs	₹ 10.50 lakhs	₹ 30 lakhs

Mr. Aakash's gross receipts for P.Y.2020-21 are ₹ 48 lakhs, out of which ₹ 3 lakhs has been received in cash and the remaining ₹ 45 lakhs through NEFT/RTGS. His profits as per books of account u/s 44AA for P.Y.2020-21 are ₹ 24.75 lakhs.

From the details given above, choose the most appropriate answer to Q. 6 to Q.10 given below–

6. Which of the following individuals are eligible to declare income on presumptive basis under the provisions of the Income-tax Act, 1961 for A.Y.2021-22?

   (a) Mr. Arvind and Mr. Aakash

   (b) Mr. Arvind, Mr. Arjun, Mr. Anand and Mr. Aakash

   (c) Mr. Arvind, Mr. Arjun and Mr. Aakash

   (d) Mr. Arvind and Mr. Arjun

7. Which of the following individuals have to mandatorily get their books of account audited under section 44AB for A.Y.2021-22?

   (a) Mr. Arjun and Mr. Anand

   (b) Mr. Arjun and Mr. Arvind

   (c) Only Mr. Anand

   (d) None of them.

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8. What is the amount of profits and gains of business chargeable to tax in the hands of Mr. Arvind, Mr. Arjun and Mr. Anand, assuming that they wish to make maximum tax savings without getting their books of account audited?

   (a) ₹ 5.50 lakhs, ₹ 10.54 lakhs and ₹ 29.12 lakhs, respectively

   (b) ₹ 5.90 lakhs, ₹ 11.10 lakhs and ₹ 30.40 lakhs, respectively

   (c) ₹ 5.90 lakhs, ₹ 11.10 lakhs and ₹ 30 lakhs, respectively

   (d) ₹ 5.50 lakhs, ₹ 10.50 lakhs and ₹ 30 lakhs, respectively.

9. Would your answer to MCQ 8 (i.e., the profits and gains of business chargeable to tax in the hands of Mr. Arvind, Mr. Arjun and Mr. Anand) undergo a change, if they decide to get their books of account audited?

   (a) The profits and gains of business chargeable to tax in the hands of Mr. Arjun and Mr. Anand would undergo a change; however, there would be no change in the case of Mr. Arvind.

   (b) The profits and gains of business chargeable to tax in the hands of Mr. Anand would undergo a change; however, there would be no change in the hands of Mr. Arvind and Mr. Arjun.

   (c) The profits and gains of business chargeable to tax in the hands of Mr. Arjun would undergo a change; however, there would be no change in the hands of Mr. Arvind and Mr. Anand.

   (d) The profits and gains of business chargeable to tax in the hands of Mr. Arvind and Mr. Arjun would undergo a change; however, there would be no change in the hands of Mr. Anand.

10. What is the due date of filing of return of income of Mr. Arvind, Mr. Arjun, Mr. Anand and Mr. Aakash for A.Y.2021-22, if they wish to make maximum tax savings?

   (a) 31st July, 2021 for all of them.

   (b) 31st July, 2021 for Mr. Arvind and Mr. Aakash; and 31st October, 2021 for Mr. Arjun and Mr. Anand

   (c) 31st July, 2021 for Mr. Arvind, Mr. Aakash and Mr. Arjun; and 31st October, 2021 for Mr. Anand

   (d) 31st July, 2021 for Mr. Arvind, Mr. Aakash and Mr. Anand; and 31st October, 2021 for Mr. Arjun

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11. ABC & Co. and PQR & Co. are two non-resident entities based in Country A and Country P, respectively. Both the entities own and operate an electronic facility through which they effect online sale of organic products manufactured by them. The details of their receipts from such sale during the P.Y.2020-21 are –

	Particulars	ABC & Co., Country A	PQR & Co., Country P
(a)	Receipts from sale of organic products to persons resident in India	₹ 138 lakhs	₹ 126 lakhs
(b)	Receipts from sale of organic products to persons resident in other parts of the world	₹ 285 lakhs	₹ 377 lakhs
	Out of the sum mentioned in (b), the receipts from persons using internet protocol address located in India	₹ 63 lakhs	₹ 73 lakhs

Is equalisation levy attracted in the hands of ABC & Co. and PQR & Co., assuming that both the entities do not have a permanent establishment in India?

(a) Equalisation levy is attracted in the hands of both ABC & Co. and PQR & Co.

(b) No equalisation levy is attracted in the hands of either ABC & Co. and PQR & Co.

(c) Equalisation levy is attracted in the hands of ABC & Co. but not PQR & Co.

(d) Equalisation levy is attracted in the hands of PQR & Co. but not ABC & Co.

12. ABC Inc., a Country A company whose place of effective management is outside India, receives royalty from A Ltd., an Indian company, in pursuance of an agreement made which is approved by the Central Government. XYZ Inc., a Country B company whose place of effective management is outside India, receives fees for technical services (FTS) from A Ltd. in pursuance of an agreement made which is approved by the Central Government. The DTAA between India and Country A provides that royalty will be subject to tax in the Source State at 9% and the DTAA between India and Country B provides that FTS will be subject to tax in the Source State at 12%. Both ABC Inc. and XYZ Inc. do not have a permanent establishment in India. ABC Inc. and XYZ Inc. have also invested in shares of Indian companies in respect of which they receive dividend. The treaty states that the dividend will be taxed at the rates provided under the domestic laws of the source country. Are ABC Inc. and XYZ Inc. required to file their return of income for A.Y.2021-22, assuming that the tax deductible at source has been fully deducted?

(a) Both ABC Inc. and XYZ Inc. have to file their return of income u/s 139 for A.Y.2021-22

(b) Both ABC Inc. and XYZ Inc. need not file their return of income u/s 139 for

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A.Y.2021-22

(c) ABC Inc. has to file its return of income u/s 139 for A.Y.2021-22, but XYZ Inc. need not file its return of income

(d) XYZ Inc. has to file its return of income u/s 139 for A.Y.2021-22, but ABC Inc. need not file its return of income.

13. Mr. Harsh has to pay ₹ 3 lakhs on 3.3.2021 to "Plan your trip", a travel agency, for a holiday package in Singapore and Malaysia for himself and his wife. He obtained a loan of ₹ 10 lakhs for higher education of his son studying in Columbia University, New York, on 20.3.2021 from SBI, and remitted the said sum through the same bank, which is also an authorised dealer. Is tax required to be collected at source from Mr. Harsh by travel agency and the bank? If so, how much?

(a) No tax is required to be collected by the travel agency since the payment for overseas tour programme package is less than ₹ 7 lakhs; tax has to be collected by SBI@5% of ₹ 3 lakhs, being the amount in excess of ₹ 7 lakhs.

(b) No tax is required to be collected by the travel agency since the payment for overseas tour programme package is less than ₹ 7 lakhs; tax has to be collected by SBI@0.5% of ₹ 3 lakhs, being the amount in excess of ₹ 7 lakhs.

(c) Tax has to be collected by the travel agency@5% on ₹ 3 lakhs; and by SBI@5% of ₹ 3 lakhs, being the amount in excess of ₹ 7 lakhs.

(d) Tax has to be collected by the travel agency@5% on ₹ 3 lakhs; and by SBI@0.5% of ₹ 3 lakhs, being the amount in excess of ₹ 7 lakhs.

14. Mr. Pranav, a resident aged 48 years, and his brother Mr. Vaibhav, a non-resident aged 45 years, received dividend of ₹ 7 lakhs and ₹ 5 lakhs, respectively, from A Ltd., an Indian company in January, 2021. The interest expenditure incurred by them in the P.Y. 2020-21 on loan taken for investing in shares of A Ltd. is ₹ 1.50 lakh and ₹ 80,000, respectively. What is the tax payable by them on such income, assuming it is the only source of income of Mr. Pranav and Mr. Vaibhav and they wish to make maximum tax savings?

(a) ₹ 25,480 and ₹ 8,840, respectively

(b) ₹ 23,400 and ₹ 7,800, respectively

(c) ₹ 19,240 and ₹ 8,840, respectively

(d) ₹ 19,240 and ₹ 1,04,000, respectively

15. ABC Ltd., an Indian company, receives dividend of ₹ 10 lakhs from its subsidiary company XYZ Ltd., also an Indian company in January, 2021. It also receives dividend of ₹ 8 lakhs in February, 2021 from MNC Inc., a foreign company, in which it holds 25% shareholding. ABC Ltd. declares dividend of ₹ 20 lakhs in April, 2021 for the F.Y.2020-21. What is the deduction available to ABC Ltd. under section 80M for

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A.Y. 2021-22?

(a) ₹ 8 lakhs

(b) ₹ 10 lakhs

(c) ₹ 18 lakhs

(d) ₹ 20 lakhs

16. Lords Inc., a British company, received, in the P.Y.2020-21, income by way of fees for technical services of ₹ 3.20 crore from Yamuna Ltd., an Indian company, in pursuance of an agreement between Yamuna Ltd. and Lords Inc. entered into in the year 2012, which is approved by the Central Government. Expenses incurred for earning such income is ₹ 28 lakhs.

    (i) Examine the taxability of the above sum in the hands of Lords Inc as per the provisions of the Income-tax Act, 1961 and the requirement, if any, to file return of income, assuming that Lords Inc does not have a permanent establishment in India.

    (ii) If Lords Inc. has a permanent establishment in India and the contract/agreement with Yamuna Ltd. for rendering technical services is effectively connected with such PE in India, examine the taxability based on the following details provided relating to P.Y.2020-21 –

	Particulars	Amount
(1)	Fees for technical services received from Yamuna Ltd.	₹ 3.20 crore
(2)	Expenses incurred for earning such income	₹ 28 lakhs
(3)	Fees for technical services received from other Indian companies in pursuance of approved agreement entered into between the years 2006 to 2010	₹ 2 crore
(4)	Expenses incurred for earning such income	₹ 21 lakhs
(5)	Expenditure not wholly and exclusively incurred for the business of such PE [not included in (2) & (4) above]	₹ 8 lakhs
(6)	Amounts paid by the PE to HO (not being in the nature of reimbursement of actual expenses)	₹ 14 lakhs

    What are the other requirements, if any, under the Income-tax Act, 1961 in this case?

17. M/s. ABC LLP filed its return of income for A.Y.2021-22, declaring total income of ₹ 18 lakhs, on 2nd October, 2021. On processing of return, the total income determined under section 143(1)(a) was ₹ 22 lakhs, after disallowing claim for deduction under section 10AA on account of late furnishing of return of income. Thereafter, on scrutiny, the Assessing Officer made some additions under section 40(a)(ia) and section 43B and

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passed an assessment order under section 143(3) assessing total income of ₹ 35 lakhs. Later on, the Assessing Officer noticed that certain income had escaped assessment and issued notice for reassessment under section 148. The total income reassessed under section 147 was ₹ 42 lakhs.

Considering that none of the additions or disallowances made in the assessment or re-assessment as above qualifies under section 270A(6), compute the amount of penalty to be levied under section 270A of the Income-tax Act, 1961 at the time of assessment under section 143(3) and at the time of reassessment under section 147 (Assume under-reporting of income is not on account of misreporting).

18. Ganga Ltd., an Indian company, earned a profit of ₹ 52 lakhs after debit/credit of the following items to its Statement of Profit and Loss for the year ended on 31.3.2021 -

(i) Items debited to Statement of Profit and Loss:

No.	Particulars	₹
1.	Provision for the loss of subsidiary	84,000
2.	Provision for doubtful debts	93,000
3.	Provision for income-tax	1,46,000
4.	Provision for gratuity based on actuarial valuation	4,17,000
5.	Depreciation	3,08,000
6.	Interest to financial institution (unpaid before filing of return)	72,000
7.	Penalty for infraction of law	14,000

(ii) Items credited to Statement of Profit and Loss:

No.	Particulars	₹
1.	Profit from unit established in special economic zone.	15,20,000
2.	Share in income of an AOP as a member	1,95,000
3.	Long term capital gains	3,20,000

Other Information:

(i) Depreciation includes ₹ 80,000 on account of revaluation of fixed assets.

(ii) Depreciation as per Income-tax Rules, 1962 is ₹ 4,12,000.

(iii) Balance of Statement of Profit and Loss shown in Balance Sheet at the asset side as at 31.3.2020 was ₹ 32 lakhs which includes unabsorbed depreciation of ₹ 18 lakhs.

(iv) The AOP, of which the company is a member, has paid tax at maximum marginal rate.

(v) Provision for income-tax includes ₹ 65,000 of interest payable on income-tax.

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Based on the above information, you are required to –

(i) Compute minimum alternate tax under section 115JB of the Income-tax Act, 1961, for A.Y. 2021-22;

(ii) What would be your answer to Q.(i), if Ganga Ltd. is a unit located in an IFSC and derives its income solely in convertible foreign exchange?

(iii) If Ganga Ltd. is a unit of an IFSC and derives its income solely in convertible foreign exchange, what would be the tax consequence of dividend distributed by it in the hands of Ganga Ltd. and its shareholders?

19. EduAid is a charitable trust set up on 1.4.2011 with the object of providing relief of the poor. Later on, in April, 2013, it changed its object to "providing education to the under privileged". It applied for registration for the first time on the basis of its new object, i.e., "education to the under privileged", on 12.8.2013 and was granted registration on 15.3.2014.

On 1.4.2020, EduAid got merged with M/s. Educare (P) Ltd, a company not entitled for registration under section 12AA. All the assets and liabilities of the erstwhile trust became the assets and liabilities of M/s. Educare (P) Ltd. The trust appointed a registered valuer for the valuation of its assets and liabilities. From the following particulars (including the valuation report), calculate the tax liability in the hands of the trust arising as a result of such merger:

(i) Land

Location	Date of purchase	Stamp duty value on 1.4.2020	Value which the land would fetch, if sold in the open market on 1.4.2020	Book Value on 1.4.2020
		₹	₹	₹
Surat	1.10.2011	42 lakhs	46 lakhs	40 lakhs
Baroda	21.11.2014	90 lakhs	105 lakhs	100 lakhs

(ii) Shares

Type of shares	Date of purchase	Face value of each share	Purchase price of each share	Price at which each share is quoted on NSE as on 1.4.2020		Open market value as on 1.4.2020#
				Highest price	Lowest price	
		₹	₹	₹	₹	₹
3000 Quoted equity shares of PQR Ltd.	4.4.2015	100	130	280	250	

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1800 Preference shares of LMN Ltd.	21.8.2016	100	100	-	-	210

on the basis of report of Merchant Banker

(iii) Liabilities

Book value of liabilities on 1.4.2020 = ₹ 112 lakhs. This includes –

(a) Corpus fund ₹ 14 lakhs.

(b) Provision for taxation ₹ 10 lakhs; and

(c) Reserves and Surplus ₹ 21 lakhs

20. Mr. Shyam, aged 47 years, is a resident individual having income from the following sources:

(i) Income from a sole-proprietary business in Noida = ₹ 50 lakhs.

(ii) Share of profit from a partnership firm in Gurgaon = ₹ 30 lakhs.

(iii) Agricultural Income (gross) from coffee estates in Country A, a foreign country with which India has no DTAA, CAD 32000. Tax deducted on the above income CAD 8,000

(iv) Brought forward business loss of F.Y.2019-20 in Country A was CAD 4,000 which is not permitted to be set off against other income as per the laws of that country.

(v) Mr. Shyam has deposited ₹ 1,50,000 in public provident fund and paid medical insurance premium of ₹ 30,000 by account payee cheque to insure his health. He has also paid ₹ 55,000 as insurance premium to insure the health of his mother and father, who are resident Indians aged 70 years and 75 years, respectively. He also incurred ₹ 50,000 on the medical treatment of his dependent sister, who is a person with disability. His sister does not claim deduction under section 80U.

Compute total income and tax liability of Mr. Shyam for the A.Y. 2021-22, assuming that 1 CAD = ₹ 60.

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SUGGESTED ANSWERS

MCQ No.	Most Appropriate Answer
1.	b
2.	d
3.	b
4.	c
5.	d
6.	c
7.	d
8.	c
9.	c
10.	d

MCQ No.	Most Appropriate Answer
11.	c
12.	c
13.	d
14.	d
15.	c

16. (i) **Where Lords Inc., a British company, does not have a PE in India**

In this case, Lords Inc. would be eligible for a concessional rate of tax@10% (plus surcharge@2% and HEC@4%) of ₹ 3.20 crore under section 115A on the fees for technical services received from Yamuna Ltd., an Indian company, since the same is in pursuance of an agreement entered into after 31.3.1976, which has been approved by the Central Government. No deduction, however, would be allowed in respect of expenditure of ₹ 28 lakhs incurred to earn such income.

If tax deductible at source@10.608% has been fully deducted, Lords Inc. need not file its return of income in India under section 139 for A.Y.2021-22.

(ii) **Where Lords Inc., a British company, has a PE in India and rendering technical services is effectively connected with the PE in India**.

Since Lords Inc. carries on business through a PE in India, in pursuance of an agreement with Yamuna Ltd. or other Indian companies entered into after 31.3.2003, and the income by way of fees for technical services is effectively connected with the PE in India as per section 44DA, such income shall be computed under the head "Profits and gains of business or profession" in accordance with the provisions of the Income-tax Act, 1961.

Accordingly, expenses of ₹ 49 lakhs (₹ 28 lakhs + ₹ 21 lakhs) incurred for earning fees for technical services of ₹ 5.20 crore (₹ 3.20 crore + ₹ 2 crore) is allowable as

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deduction therefrom. However, expenditure of ₹ 8 lakhs which is not incurred wholly and exclusively for the business of the PE and the amount of ₹ 14 lakhs paid by the PE to the HO is **not** allowable as deduction.

Lords Inc. is required to maintain books of account under section 44AA and get the same audited under section 44AB and furnish report before the specified date i.e., the date one month prior to the due date of filing return u/s 139(1) for A.Y.2021-22.

17. M/s. ABC LLP is deemed to have under-reported its income since:

(1) its income assessed under 143(3) exceeds its income determined in a return processed under section 143(1)(a); and

(2) the income reassessed under section 147 exceeds the income assessed under section 143(3).

Therefore, penalty is leviable under section 270A for under-reporting of income.

Computation of penalty leviable under section 270A

Particulars	₹	₹
Assessment under section 143(3)		
Under-reported income:		
Total income assessed under section 143(3)	35,00,000	
(-) Total income determined u/s 143(1)(a)	22,00,000	
	13,00,000	
Tax payable on under-reported income:		
Tax on under-reported income of ₹ 13 lakhs *plus* total income of ₹ 22 lakhs determined u/s 143(1)(a) *[30% of ₹ 35 lakh + HEC@4%]*	10,92,000	
Less: Tax on total income determined u/s 143(1)(a) *[30% of ₹ 22 lakh +HEC@4%]*	6,86,400	
	4,05,600	
Penalty leviable@50% of tax payable		2,02,800
Reassessment under section 147		
Under-reported income:		
Total income reassessed under section 147	42,00,000	
(-) Total income assessed under section 143(3)	35,00,000	
	7,00,000	
Tax payable on under-reported income:		
Tax on under-reported income of ₹ 7 lakhs *plus* total income of ₹ 35 lakhs assessed u/s 143(3) *[30% of ₹ 42*	13,10,400	

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lakh + HEC@4%]		
Less: Tax on total income assessed u/s 143(3) *[30% of ₹ 35 lakh + HEC@4%]*	10,92,000	
	2,18,400	
Penalty leviable@50% of tax payable		1,09,200

18. (i) Computation of "Book Profit" for levy of MAT under section 115JB for A.Y. 2021-22

Particulars	₹	₹
Net Profit as per Statement of Profit and Loss		52,00,000
Add: Net profit to be increased by the following amounts as per *Explanation 1* to section 115JB:		
- Provision for the loss of subsidiary	84,000	
- Provision for doubtful debts, being the amount set aside as provision for diminution in the value of any asset	93,000	
- Provision for income-tax	1,46,000	
[As per *Explanation 2* to section 115JB, income-tax shall include, *inter alia*, any interest charged under the Act, therefore, whole of the amount of provision for income-tax including ₹ 65,000 towards interest payable has to be added]		
- Depreciation as per books of account	3,08,000	6,31,000
		58,31,000
Less: Net profit to be decreased by the following amounts as per *Explanation 1* to section 115JB:		
- Share in income of an AOP as a member	1,95,000	
[In a case where AOP has paid tax on its total income at maximum marginal rate, no income-tax is payable by the company, being a member of AOP, in accordance with the provisions of section 86. Therefore, share in income of an AOP on which no income-tax is payable in accordance with the provisions of section 86, would be reduced while computing book profit, since the same has been credited to statement of profit and loss]		

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- Depreciation other than depreciation on revaluation of assets (₹ 3,08,000 – ₹ 80,000)	2,28,000	
- Unabsorbed depreciation or brought forward business loss, whichever is less, as per the books of account.	14,00,000	
[Lower of unabsorbed depreciation ₹ 18,00,000 and brought forward business loss ₹ 14,00,000 as per books of accounts has to be reduced while computing the book profit]		18,23,000
Book Profit		**40,08,000**

Computation of MAT liability under section 115JB

Particulars	₹
15% of book profit of ₹ 40,08,000	**6,01,200**
Add: Health & Education Cess@4%	24,048
Minimum Alternate Tax liability	**6,25,248**
MAT liability (rounded off)	6,25,250

Notes:

(1) It is only the specific items mentioned under *Explanation 1* to section 115JB, which can be adjusted from the net profit as per the Statement of Profit and Loss prepared as per the Companies Act for computing book profit for levy of MAT. Since the following items are not specified thereunder, the same cannot be adjusted for computing book profit:

Interest to financial institution (unpaid before filing of return) and

Penalty for infraction of law

(2) Provision for gratuity based on actuarial valuation is an ascertained liability *[CIT v. Echjay Forgings (P) Ltd. (2001) 251 ITR 15 (Bom.)]*. Hence, the same should not be added back to compute book profit.

(3) As per proviso to section 115JB(6), the profits from unit established in special economic zone cannot be excluded while computing the book profit, and hence, such income would be liable for MAT.

(ii) Computation of MAT liability u/s 115JB where Ganga Ltd. is a unit located in an IFSC and derives its income solely in convertible foreign exchange

Particulars	₹
9% of book profit of ₹ 40,08,000	3,60,720
Add: Health & Education Cess@4%	14,429

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Minimum Alternate Tax liability	**3,75,149**
MAT liability (rounded off)	3,75,150

(iii) As per section 115-O(8), no tax on distributed profits is chargeable in respect of the total income of a company, being a unit of an IFSC deriving income solely in convertible foreign exchange, on any amount of declared, distributed or paid by the company by way of dividends, either in the hands of the company or the person receiving such dividend.

Thus, neither the company nor the shareholders have to pay any tax on dividend distributed by Ganga Ltd.

19. As per section 115TD, the accreted income of "EduAid", a charitable trust, registered under section 12AA which is merged with M/s Educare (P) Ltd., an entity not entitled for registration under section 12AA, would be chargeable to tax at the rate of 34.944% [30% plus surcharge @12% plus cess@4%].

Computation of accreted income and tax liability in the hands of the EduAid trust arising as a result of merger with M/s. Educare (P) Ltd.

Particulars	Amount (₹)
Aggregate FMV of total assets as on 1.4.2020, being the specified date (date of merger) **[See Working Note 1]**	1,16,73,000
Less: Total liability computed in accordance with the prescribed method of valuation **[See Working Note 2]**	67,00,000
Accreted Income	**49,73,000**
Tax Liability @ 34.944% of ₹ 49,73,000 (rounded off)	**17,37,765**
Working Notes:	
(1) Aggregate fair market value of total assets on the date of merger	
- **Land at Surat, being immovable property, purchased on 1.10.2011** Since the trust was registered only on 15.3.2014 and benefit of section 11 and 12 was available to the trust only from A.Y.2014-15, relevant to P.Y.2013-14, being the previous year in which the application for registration is made, the value of land purchased in P.Y.2011-12, in respect of which benefit under sections 11 and 12 was not availed, has to be ignored for computing accreted income.	-

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- **Land at Baroda, being an immovable property, purchased on 21.11.2014** [The fair market value of land would be higher of ₹ 105 lakhs i.e., price that the land would ordinarily fetch if sold in the open market and ₹ 90 lakhs, being stamp duty value as on the specified date, i.e., 1.4.2020]	1,05,00,000
- **Quoted equity shares of PQR Ltd. [3,000 x ₹ 265 per share]** [₹ 265 per share, being the average of the lowest (₹ 250) and highest price (₹ 280) of such shares on the specified date]	7,95,000
- **Preference shares of LMN Ltd. [1,800 x ₹ 210 per share]** [The fair market value which it would fetch if sold in the open market on the specified date i.e. FMV on 1.4.2020]	3,78,000
	1,16,73,000
(2) Total liability	
- Reserves and Surplus ₹ 21 lakhs [not includible]	-
- Corpus Fund of ₹ 14 lakhs [not includible]	-
- Provision for taxation ₹ 10 lakhs [not includible]	-
- Other Liabilities [₹ 112 lakhs - ₹ 21 lakhs - ₹ 14 lakhs - ₹ 10 lakhs]	67,00,000
	67,00,000

20. Computation of total income and tax liability of Mr. Shyam for A.Y. 2021-22

Particulars	₹	₹
Profits and gains from business and profession		
Income from sole proprietary concern in India	50,00,000	
Share of profit from a partnership firm in India of ₹ 30 lakhs, is exempt	Nil	
Business profit	50,00,000	
Less: Business Loss[1] in Country A (CAD 4000 x ₹ 60/CAD)	2,40,000	47,60,000

[1] Since the eight year has not expired from the assessment year in which such business loss was incurred, such business loss can be set-off against current year business income.

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Income from Other Sources		
Agricultural income from coffee estates in Country A, is taxable in India (CAD 32000 x ₹ 60/CAD)		19,20,000
Gross Total Income		**66,80,000**
Less: **Deductions under Chapter VI-A**		
Under section 80C [deposit in PPF]	1,50,000	
Under section 80D	75,000	
[Medical insurance premium paid ₹ 30,000 for self, restricted to ₹ 25,000; ₹ 55,000 for senior citizen parents, restricted to ₹ 50,000]		
Under section 80DD		
[Flat deduction of ₹ 75,000 irrespective of the expenditure incurred on dependent sister, being a person with disability]	75,000	
		3,00,000
Total Income		**63,80,000**
Tax on total income		
Tax on ₹ 63,80,000 [(30% x ₹ 53,80,000) *plus* ₹ 1,12,500]		17,26,500
Add: Surcharge@10%, since total income exceeds ₹ 50 lakh		1,72,650
		18,99,150
Add: HEC@4%		75,966
		19,75,116
Average rate of tax in India [i.e., ₹ 19,75,116/₹ 63,80,000 x 100]	30.96%	
Average rate of tax in Country A [i.e., CAD 8000/CAD 32000]	25%	
Doubly taxed income [₹ 19,20,000 – ₹ 2,40,000]	16,80,000	
Rebate under section 91 on ₹ 16,80,000@25% (lower of average Indian tax rate and rate of tax in Country A)		4,20,000
Tax payable in India [₹ 19,75,116 – ₹ 4,20,000]		**15,55,116**
Tax payable in India (rounded off)		**15,55,120**

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Note:

(1) *Since Mr. Shyam is resident in India for the P.Y.2020-21, his global income would be subject to tax in India. He is eligible for deduction under section 91 since the following conditions are fulfilled:-*

(a) He is a resident in India during the relevant previous year.

(b) Agricultural income accrues or arises to him outside India during that previous year.

(c) Such agricultural income is not deemed to accrue or arise in India during the previous year.

(d) The income in question i.e., agricultural income, has been subjected to income-tax in Country A in his hands and he has paid tax on such income in Country A.

(e) There is no agreement under section 90 for the relief or avoidance of double taxation between India and Country A, where the income has accrued or arisen.

(2) *If Mr. Shyam opts for section 115BAC, he would not be able to claim deduction of ₹ 3,00,000 under Chapter VI-A. His total income would be ₹ 66,80,000. His tax liability would be ₹ 19,92,276 (working shown below), which is higher than the tax liability of ₹ 19,75,116 computed as per the regular provisions of the Act. Hence, he would not opt for section 115BAC.*

Particulars	***₹***
Upto ₹ 2,50,000	*Nil*
₹ 2,50,001 – ₹ 5,00,000 [₹ 2,50,000 @ 5%]	*12,500*
₹ 5,00,001 – ₹ 7,50,000 [₹ 2,50,000 @ 10%]	*25,000*
₹ 7,50,001 – ₹ 10,00,000 [₹ 2,50,000 @ 15%]	*37,500*
₹ 10,00,001 – ₹ 12,50,000 [₹ 2,50,000 @ 20%]	*50,000*
₹ 12,50,001 – ₹ 15,00,000 [₹ 2,50,000 @ 25%]	*62,500*
₹ 15,00,001 – ₹ 66,80,000 [₹ 51,80,000 @ 30%]	*15,54,000*
	17,41,500
Add: Surcharge @ 10%	*1,74,150*
	19,15,650
Add: HEC @ 4%	*76,626*
Total tax liability	***19,92,276***
Total tax liability (rounded off)	***19,92,280***

PAPER-8: INDIRECT TAX LAWS

QUESTIONS

> **(1) All questions should be answered on the basis of position of (i) GST law as amended by the provisions of the Finance Act, 2020 and the Finance (No. 2) Act, 2019, which have become effective up to 31st October, 2020, including significant notifications and circulars issued and other legislative amendments made, up to 31st October, 2020 and (ii) customs law as amended by the Finance Act, 2020, including significant notifications and circulars issued and other legislative amendments made, up to 31st October, 2020.**
>
> **(2) The GST rates for goods and services mentioned in various questions are hypothetical and may not necessarily be the actual rates leviable on those goods and services. The rates of customs duty are also hypothetical and may not necessarily be the actual rates. Further, GST compensation cess should be ignored in all the questions, wherever applicable.**

Disha Enterprise Pvt Ltd. is a financial service company having its offices in Kolkata, West Bengal and Mumbai, Maharashtra. The company is registered under GST in both the States. The company operates through two segments (a) banking & insurance services and (b) advisory & consulting services. The aggregate turnover of the company during the previous year was (i) ₹ 80 lakh in West Bengal & (ii) ₹ 60 lakh in Maharashtra.

The bouquet of services provided under each of the two segments are as follows:

Banking & insurance services	**Advisory & consulting services**
Insurance agent services	Company/LLP/Society formation
Recovery agent services	Return filing
Direct Selling Agent (DSA) services (sale of banking products)	Detailed Project Report (DPR) preparation
	Business promotion/ product marketing/ exhibition etc.

The company has carried out following transactions during the month of September:

(Amount in ₹ excluding GST)

Particulars	**Kolkata office**	**Mumbai office**
Sale and purchase of foreign currency	Refer Note 3	Refer Note 3
Commission received from Nautiyal Insurance Company/ ADFC Life Insurance Company	90,000	70,000
Commission received as DSA from ICIDI Bank for opening bank account/credit card & loan products	48,000	50,000

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Commission received from private banks for acting as recovery agent	1,20,000	1,50,000
Professional fee received for the formation of a company/LLP/society	80,000 [Refer Note 2]	40,000
Professional fee received for GST/ TDS return filing	65,000	75,000
Participation fee received from customers for the business exhibition organised by the company	50,00,000 (held in Russia) [Refer Note 1]	4,00,000 (held at Chennai) [Refer Note 1]
Legal fee paid to Mr. Sundaram - an advocate	10,000	15,000
Payment made for security services (by way of supply of security personnel) received	25,000 (Globe Security Pvt Ltd.)	25,000 (M/s X & Co, a partnership firm, registered under GST)

Notes:

1. The participation fee of ₹ 50,00,000 received by the company is in respect of a business exhibition organized at St. Petersburg, Russia under the theme "Indian Traditional Fair" in which 10 Indian companies (all registered under GST) had participated. A participation fee of ₹ 5 lakh from each Indian company was collected for providing them a stall, furniture & other amenities at St. Petersburg, Russia.

   The participation fee of ₹ 4,00,000 is in respect of a business exhibition organized by the company at Chennai, in which 100 Indian companies had participated.

2. Out of the professional fee of ₹ 80,000 received by Kolkata office for the formation of a company/LLP/society, ₹ 15,000 was towards reimbursement claimed from client. It was separately mentioned in the invoice indicating that it was deposited with registrar of companies (ROC).

3. Following purchase & sale of foreign currency was made by the company during the month of September:

   (a) Kolkata office had purchased USD 10,000 from M/s Moneywise (a FOREX dealer) @ ₹ 74 per USD on 10th September. The RBI reference rate on that day was ₹ 73 per USD.

   (b) Mumbai office had sold USD 5,000 to M/s Money Matters (a FOREX dealer) on 15th September @ ₹ 73.20 per USD. RBI reference rate for USD on that day is not available.

4. In an order dated 14th September issued to Disha Enterprise Pvt Ltd., the Joint Commissioner of CGST, Mumbai has raised a demand of ₹ 600 crore on Mumbai office in

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respect of an inter-State transaction. The company is disputing the entire demand & wants to file an appeal before the Appellate Authority against the order of Joint Commissioner.

5. The Kolkata office of the company had received ₹ 1 lakh on 22nd April as an advance from Ganesh Flour Mill Pvt Ltd., a client, for preparation of DPR. However, tax collected on the same from the client has not yet been deposited with the Central Government.

All the amounts given above are exclusive of GST wherever applicable (unless otherwise specified). There is no other outward or inward supply transaction apart from the aforesaid transactions in the relevant period.

Based on the facts of the case scenario given above, choose the most appropriate answer to Q. Nos. 1. to 5. below:-

1. Determine the value of taxable supply in respect of sale and purchase of foreign currency by Kolkata office and Mumbai office of the company as per rule 32(2)(a) of the CGST Rules, 2017.

   (a) Kolkata office ₹ 7200, Mumbai office ₹ 3,660

   (b) Kolkata office ₹ 10,000, Mumbai office ₹ 3,660

   (c) Kolkata office ₹ 7,20,000, Mumbai office ₹ 3,66,000

   (d) Kolkata office ₹ 7,30,000, Mumbai office ₹ 3,66,000

2. The value of taxable supply received by Mumbai office in the month of September on which tax is payable under reverse charge is _____________.

   (a) ₹ 15,000

   (b) ₹ 25,000

   (c) ₹ 40,000

   (d) ₹ 2,70,000

3. The value of taxable outward supply made by Kolkata office in the month of September on which Disha Enterprise Pvt Ltd. is liable to pay tax under forward charge is ________________.

   (a) ₹1,78,000

   (b) ₹ 2,78,000

   (c) ₹ 2,65,000

   (d) ₹ 1,13,000

4. The maximum amount of pre-deposit that Disha Enterprise Pvt. Ltd. can be asked to deposit under the IGST Act, 2017 for filing of an appeal before the Appellate Authority is _____________.

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(a) ₹ 30 crores

(b) ₹ 60 crores

(c) ₹ 25 crores

(d) ₹ 50 crores

5. The maximum penalty prescribed under section 122 of the CGST Act, 2017 for failure of Kolkata Office to deposit the tax collected on the advance received from Ganesh Flour Mill Pvt Ltd. is ___________.

   (a) ₹ 18,000

   (b) ₹ 25,000

   (c) ₹ 10,000

   (d) ₹ 10,000 or tax evaded, whichever is higher.

ABC Ltd. is a Public Sector Undertaking (PSU) engaged in the business of generation of electricity from conventional & non-conventional sources. The Government of India holds 75% equity in the said company & balance equity is held by institutional and domestic investors. The company has taken separate registration under GST in each State where it has business operations. The company has its head office (HO) in Delhi & its power plants are located in the States of Bihar, Odisha & Chhattisgarh.

Following transactions were carried out by the company during the month of February:

(Amount in ₹)

Particulars	Delhi H.O	Bihar plant	Odisha plant	Chhattisgarh plant
Sale of electrical energy to DISCOM	---	2,50,00,000	3,50,00,000	4,50,00,000
Bank interest received on saving bank account & fixed deposit	18,00,000	3,00,000	5,00,000	8,00,000
House rent recovered from the employees for residential accommodation provided to them	55,000	30,000	25,000	40,000
Rent collected from bank, ATM, post office & shops located in office premises	48,000	15,000	12,000	16,000
Sale of iron/ metal scrap (excluding TCS @ 1% as per the Income-tax Act, 1961	-	85,000	45,000	65,000
Other Income	2,50,000	-	-	45,000

Note:

(a) Other income of Delhi H.O. amounting to ₹ 2,50,000 is in respect of bond money recovered from an ex-employee who had resigned from the service of ABC Ltd. prior to completion of the period specified in the bond, viz., 2 years.

(b) Other income of ₹ 45,000 of Chhattisgarh plant is in respect of penalty recovered from a contractor for delay in supply of material.

In addition to above information, following transactions were also carried out during the month of February:

(1) A supply order for stationery items was awarded by Delhi H.O. to M/s Stationery Mart, New Delhi for ₹ 3,36,000 (including GST @ 12%) in January.

The vendor supplied stationery items worth ₹ 44,800 (including GST@ 12%) & issued the tax invoice in February. Delhi H.O. had made the payment of the said bill in February. The remaining amount was paid in April on supply of balance items.

(2) Odisha plant purchased office furniture for ₹ 2,80,000 during February from an unregistered dealer. Rate of GST on said furniture item is 18%.

(3) A Board meeting for raising term loan for project expansion was held in February. The Delhi H.O. paid ₹ 20,000 each as sitting fee to 4 independent directors who attended the meeting.

(4) For safety & security of its H.O. & power plants, the company has engaged private security as well as CISF. Following payments were made in February, in respect of bills issued in the month of January:

Particulars	Delhi H.O.	Bihar plant	Odisha plant	Chhattisgarh plant
CISF	---	10,00,000 (paid on 07th February)	8,00,000 (paid on 15th February)	14,00,000 (paid on 05th February)
ABS Security Services Pvt Ltd.	5,00,000 (paid on 11th February)	-	-	-

(5) The Bihar plant purchased a machinery in February from M/s Sahoo Enterprises, Patna (not registered under GST) for ₹ 86,000. Full payment was made in February. Rate of GST on the said machinery is 18%.

All the amounts mentioned above are excluding GST, wherever applicable (unless otherwise specified).

Based on the facts of the case scenario given above, choose the most appropriate answer to Q. Nos. 6. to 10. below:

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6. The value of taxable supply on which GST is payable by Delhi H.O. under forward charge, for the month of February is ___________.

   (a) ₹ 21,78,000

   (b) ₹ 2,98,000

   (c) ₹ 22,33,000

   (d) ₹ 3,78,000

7. The value of taxable inward supply on which GST shall be payable under reverse charge by Bihar power plant is __________.

   (a) ₹ 11,80,000

   (b) ₹ 10,00,000

   (c) ₹ 10,86,000

   (d) ₹ 10,30,000

8. The value of supply on which TDS under section 51 of the CGST Act, 2017 shall be deducted by Delhi H.O. while making payment to M/s Stationery Mart in February is ___________.

   (a) ₹ 40,000

   (b) ₹ 44,800

   (c) ₹ 3,00,000

   (d) TDS is not applicable since payment made in February is less than ₹ 2,50,000.

9. Which of the following statements is true with regard to the penalty of ₹ 45,000 recovered by Chhattisgarh plant from the contractor for delay in supply of material?

   (a) Fine/ penalty levied by a PSU is an exempt supply under section 11 of the CGST Act, 2017.

   (b) It is a supply of services as stipulated in Schedule II of the CGST Act, 2017.

   (c) It is neither a supply of service nor supply of goods as it is covered under Schedule III of the CGST Act, 2017.

   (d) It is not a supply at all under section 7 of the CGST Act, 2017.

10. What is the value of supply on which GST is payable by Odisha plant on sale of scrap?

   (a) ₹ 45,000

   (b) ₹ 45,450

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(c) Sale of scrap is an exempt supply under GST. It is subject to TCS under the Income-tax Act, 1961.

(d) Sale of scrap is neither a supply of service nor supply of goods as it is covered under Schedule III of the CGST Act, 2017.

11. The Resident Welfare Association (RWA) of Kutumb Housing Society is registered under GST in the State of Mahrashtra. There are 100 three BHK flats and 100 four BHK flats in the society. It received/paid the following amounts (excluding GST, wherever applicable) in the months of January and February:

Particulars	**January (₹)**	**February (₹)**
Maintenance charges per flat received from all 3 BHK flat owners	7,000	7,000
Maintenance charges per flat received from all 4 BHK flat owners	10,000	10,000
Interest received on the fixed deposit with Dhansukh Bank	5,00,000	5,00,000
Generator purchased for the power back-up of 4 BHK flats		1,00,000
Taps, pipes, other sanitary fittings purchased for 3 BHK flats	50,000	

Determine the net GST liability to be paid for the months of January and February, assuming that the GST rate is 18% on all inward and outward supplies.

(a) January - ₹ 1,71,000; February - ₹ 1,62,000

(b) January - ₹ 1,80,000; February - ₹ 1,62,000

(b) January - ₹ 1,80,000; February - ₹ 1,80,000

(d) January - ₹ 1,71,000; February - ₹ 1,80,000

12. Suhasini Oberoi, an Indian resident who was on a visit to USA, returned after 6 months for contesting in assembly elections of her State. She was carrying with her the following items:

(i)	Personal effects	₹ 59,000
(ii)	Laptop computer	₹ 37,000
(iii)	Jewellery - 25 grams (purchased in USA)	₹ 67,000
(iv)	Music system	₹ 58,000

Compute the customs duty payable by Suhasini Oberoi with reference to the Baggage Rules, 2016.

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(a) ₹ 28,875

(b) ₹ 62,370

(c) ₹ 85,085

(d) ₹ 48,125

13. M/s Sohan Enterprises Ltd. had imported goods after paying the customs duty of ₹ 25,00,000 at the time of import. These goods were used and later re-exported after 19 months of import. The amount of duty drawback that M/s Sohan Enterprises Ltd. is eligible to claim on such re-export made is ___________.

(a) nil

(b) 23,75,000

(c) 20,00,000

(d) 24,00,000

14. Sunshine Pvt. Ltd. manufactures taxable goods. The company is registered under GST in the State of West Bengal. The company has provided following information in relation to inward supplies received by it in the month of October:

S. No.	Invoices received for inward supplies	IGST (₹)
1.	Raw material - X	2,00,000
2.	Rent of the factory building	1,50,000
3.	Raw material - Y	1,30,000
4.	Car purchased for the use of the director	1,20,000
5.	Consumables	80,000
6.	Machinery for being used in the manufacturing process	1,50,000
7.	Raw material - Z	1,10,000
8.	Technical consultancy for improvement in the manufacturing process	60,000
9.	Raw material – W (imported from China)	50,000
Total		10,50,000

S. No.	Particulars	IGST (₹)
(i)	Balance in Form GSTR-2A on 28th October	4,80,000

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	(Invoices at S. Nos. 1, 2 and 3 uploaded by the respective suppliers in their Form GSTR-1s)	
(ii)	Balance in Form GSTR-2A on 11th November (Invoices at S. Nos. 1, 2, 3 and 4 uploaded by the respective suppliers in their Form GSTR-1s)	6,00,000
(iii)	Balance in Form GSTR-2A on 20th November (Invoices at S. Nos. 1, 2, 3, 4 and 5 uploaded by the respective suppliers in their Form GSTR-1s)	6,80,000

Compute the ITC that can be claimed by Sunshine Pvt. Ltd. in its Form GSTR-3B for the month of October to be filed by 20th November.

Note: The due date of filing of Form GSTR-1 and Form GSTR-3B for the month of October are 11th November and 20th November respectively. Subject to the information given above, all the other conditions for availing ITC have been complied with.

15. Parikshit Ltd., engaged in providing a bouquet of services, is registered under GST law. It furnishes the following information for the month of March in relation to various services provided by it:

Particulars	₹
Fees from prospective employers for campus interview in its college	5,20,000
Five buses each with seating capacity of 40 passengers given on hire to State Transport Undertaking	6,50,000
Receipts of 'Shiny', a commercial coaching institute providing coaching in the field of commerce (a certificate was awarded to each trainee after completion of the training)	1,82,000
Interest received on fixed deposits of the company with Dhanvarsha Bank	6,50,000
Receipts from running a Boarding School (including receipts for providing residential dwelling service of ₹ 18,20,000)	39,00,000
Receipts of 'Sikshit Samudai' - an Industrial Training Institute (ITI) affiliated to the National Council for Vocational Training (NCVT). Courses run by said ITI are in designated trades	2,60,000
Receipts of 'Pratibha Institute', an institute registered with Directorate General of Employment and Training (DGET), Union Ministry of Labour and Employment, running a Modular Employable Skill Course (MESC) approved by the National Council for Vocational Training (NCVT)	1,30,000
Professional services provided to foreign diplomatic mission located in India	1,04,000

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Compute the GST payable by Parikshit Ltd. assuming that all the above receipts are exclusive of GST wherever applicable and the rate of GST applicable on all the supplies is 18%.

16. Briefly examine whether the appeal/review application filed in the following independent cases is within the time limit prescribed under the GST law:-

    (i) The adjudicating authority issued the adjudication order on 23rd April and the same is communicated to the taxpayer - Mr. X - on 28th April. Mr. X, aggrieved by the order of the adjudicating authority filed an appeal to the Appellate Authority on 26th July.

    (ii) The adjudicating authority passed the order on 3rd March (communicated same day to the Commissioner). The Commissioner directs his subordinate officer to file a review application with the Appellate Authority. The subordinate officer filed the review application on 23rd September.

17. Determine the place of supply in the following independent cases:-

    (i) Mr. Sahukaar (New Delhi) boards the New Delhi-Kota train at New Delhi. Mr. Sahukaar sells the goods taken on board by him (at New Delhi), in the train, at Jaipur during the journey.

    (ii) Vidhyut Pvt. Ltd. imports electric food processors from China for its Kitchen Store in Noida, Uttar Pradesh. Vidhyut Pvt. Ltd. is registered in Uttar Pradesh.

    (iii) Mr. Aatmaram, a manager in a Bank, is transferred from Bareilly, Uttar Pradesh to Bhopal, Madhya Pradesh. Mr. Aatmaram's family is stationed in Kanpur, Uttar Pradesh. He hires Gokul Carriers of Lucknow, Uttar Pradesh (registered in Uttar Pradesh), to transport his household goods from Kanpur to Bhopal.

    (iv) Bholunath, a resident of New Delhi, opens his saving account in New Delhi branch of Best Bank after undergoing the KYC process. He goes to Amritsar for some official work and withdraws money from Best Bank's ATM in Amritsar thereby crossing his limit of free ATM withdrawals.

    (v) Mr. Chakmak, an architect (New Delhi), enters into a contract with Mr. Zeeshaan of New York to provide professional services in respect of immovable properties of Mr. Zeeshaan located in Pune and New York.

18. Paridhi Ltd. is a registered manufacturer engaged in taxable supply of goods. Paridhi Ltd. purchased the following goods during the month of January and provided the following information:

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S. No.	Particulars	GST paid (₹)
1.	Capital goods purchased on which depreciation has been taken on full value including input tax thereon	15,000
2.	Goods purchased from Rupesh Enterprises (Rupesh Enterprises sent the invoice in the month of January, but goods were received in month of April)	20,000
3.	Car purchased for making further supply of such car. Such car is destroyed in accident while being used for test drive by potential customers	30,000
4.	Goods used for setting up telecommunication towers being immovable property	50,000
5.	Goods purchased from Sumo Ltd. (Full payment has been made by Paridhi Ltd. to Sumo Ltd. against such supply, but tax has been deposited by Sumo Ltd. in April)	10,000
6.	Truck purchased for delivery of output goods	80,000

Determine the amount of input tax credit (ITC) available to Paridhi Ltd. while filing GSTR-3B for the month of January by giving necessary explanations for treatment of various items as per the provisions of the CGST Act, 2017. You may assume that all the necessary conditions for availing the ITC have been complied with by Paridhi Ltd.

19. SGNA Industries Ltd. of Surat imported one machine through vessel from Japan, in the month of September and has furnished the following details:-

S. No.	Particulars	Amount in Japanese Yen (¥)
(i)	Cost upto port of exportation incurred by exporter	5,00,000
(ii)	Loading charges at port of exportation	1,25,000
(iii)	Freight charges from port of export to port of import in India.	50,000

Following additional amounts paid by SGNA Industries Ltd.:-

(i) Designing charges, necessary for such machine, paid to consultancy firm in Mumbai ₹ 9,50,000

(ii) Commission paid (not the buying commission) to local agent of exporter ₹ 50,000

(iii) Actual landing charges paid at the place of importation ₹ 20,000

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(iv) Actual insurance charges paid to the place of importation are not ascertainable.

(v) Lighterage charges paid at the port of importation ₹ 30,000

The rate of basic customs duty is 10% and rate of social welfare surcharge is 10%. Integrated tax leviable under section 3(7) of Customs Tariff Act, 1975 is 12%. The rate of exchange to be taken is 1 Japanese Yen (¥) = ₹ 0.68. Ignore GST compensation cess.

You are required to compute the total customs duty, including integrated tax payable under section 3(7) of the Customs Tariff Act, 1975 with appropriate working notes.

20. KTU Limited has imported certain goods for sale in India from Country Z, which are liable for anti-dumping duty. Country Z sell the like goods in its domestic market in the ordinary course of trade at USD 300 per piece. The imported goods are sold in domestic Indian industry @ USD 275 per piece. KTU Limited has imported the goods at USD 180 per piece. Landed value of the imported goods is USD 190 per piece.

Compute the anti-dumping duty payable by KTU Limited for 800 pieces of these goods it has imported during the year assuming conversion rate @ ₹ 72 per USD.

SUGGESTED ANSWERS

1. (b)

2. (c)

3. (a)

4. (d)

5. (d)

6. (b)

7. (b)

8. (a)

9. (b)

10. (a)

11. (b)

12. (a)

13. (a)

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14. ITC to be claimed by Sunshine Pvt. Ltd. in its GSTR-3B for the month of October to be filed by 20th November will be computed as under-

Invoices	**Amount of input tax involved in the invoices (₹)**	**Amount of ITC that can be availed (₹)**
Balance in GSTR-2A on 11th November [Note 1] (Invoices at S. Nos. 1, 2, 3 and 4 uploaded by the respective suppliers in their GSTR-1s)	6,00,000	4,80,000 [Note 2]
Invoices at S. Nos. 5, 6 7 and 8 not uploaded in GSTR-1	4,00,000	48,000 [Note 3]
Invoice at S. No. 9	50,000	50,000 [Note 4]
Total	10,50,000	5,78,000

Notes:

(1) ITC in respect of the invoices whose details have not been uploaded by the suppliers shall not exceed 10% of the eligible input tax credit available to the recipient in respect of invoices or debit notes the details of which have been uploaded by the suppliers under section 37(1) of the CGST Act, 2017 as on the due date of filing of the returns in Form GSTR-1 of the suppliers for the said tax period. The taxpayer can ascertain the same from his auto populated Form GSTR 2A as available on the due date of filing of Form GSTR-1 under section 37(1) [Rule 36(4) of the CGST Rules, 2017 read with *Circular No. 123/42/2019 GST dated 11.11.2019*].

(2) 100% ITC can be availed on invoices uploaded by the suppliers in their Form GSTR-1. However, section 17(5) of the CGST Act, 2017 blocks ITC on motor vehicles for transportation of persons having approved seating capacity of not more than 13 persons if they are not used for making the following taxable supplies, namely:—

(A) further supply of such motor vehicles; or

(B) transportation of passengers; or

(C) imparting training on driving such motor vehicles

Since Sunshine Pvt. Ltd. is not using the car for any of the aforesaid mentioned purpose, ITC thereon will not be available.

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Thus, 100% ITC will be available in respect of invoices at S.Nos. 1, 2 & 3.

(3) In respect of invoices at S.Nos. 5, 6 7 and 8 not uploaded in Form GSTR-1s, the ITC has been restricted to 10% of eligible ITC in respect of invoices uploaded in Form GSTR-1s, i.e. 10% of ₹ 4,80,000 in terms of rule 36(4) of the CGST Rules, 2017.

(4) The restriction of availment of ITC is imposed only in respect of those invoices, details of which are required to be uploaded by the suppliers under section 37(1) of the CGST Act, 2017 and which have not been uploaded. Therefore, full ITC can be availed in respect of IGST paid on imports which are outside the ambit of section 37(1) *[Circular No. 123/42/2019 GST dated 11.11.2019].*

15. Computation of GST payable by Parikshit Ltd. for the month of March

Particulars	**Value (₹)**	**GST @ 18% (₹)**
Fees from prospective employers for campus interview in its college [Taxable since such services are not specifically exempt]	5,20,000	93,600
Five buses each with seating capacity of 40 passengers given on hire to State Transport Undertaking [Services by way of giving on hire to a State transport undertaking (STU), a motor vehicle meant to carry more than 12 passengers, are exempt vide *Notification No. 12/2017 CT(R) dated 28.06.2017* (hereinafter referred to as exemption notification).]	Nil	Nil
Receipts of Shiny– a coaching institute [Services provided by an educational institution to its students, faculty and staff are exempt vide exemption notification. However, coaching institute is not an educational institution.]	1,82,000	32,760
Interest received on fixed deposits of the company with Dhanvarsha Bank [Services by way of extending deposits, loans or advances in so far as the consideration is represented by way of interest or discount (other than interest involved in credit card services) are exempt vide exemption notification.]	Nil	Nil
Receipts from Boarding School including receipts for residential dwelling service [Services provided by an educational institution to its students, faculty and staff are exempt vide exemption	Nil	Nil

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notification. Boarding School providing education up to higher secondary school or equivalent is an educational institution since it provides composite supply of education service coupled with other services like providing dwelling units for residence and food wherein the principal supply is supply of education service.]		
Receipts of Sikshit Samudai [Services provided by an educational institution to its students, faculty and staff are exempt vide exemption notification. Sikshit Samudai is an educational institution running approved vocational education course.]	Nil	Nil
Receipts of 'Pratibha Institute' running Modular Employable Skill Course [Services provided by an educational institution to its students, faculty and staff are exempt vide exemption notification. Pratibha Institute is an educational institution running approved vocational education course.]	Nil	Nil
Professional services provided to foreign diplomatic mission located in India [While services provided by a foreign diplomatic mission located in India are exempt from GST vide exemption notification, no such exemption is available to the services provided to such mission.]	1,04,000	18,720
GST payable	8,06,000	1,45,080

16. (i) A person aggrieved by any decision/order of an adjudicating authority can file an appeal to the Appellate Authority within 3 months from the date of communication of such decision/order. The Appellate Authority can condone the delay in filing of appeal by 1 month if it is satisfied that there was a sufficient cause for such delay [Section 107 of the CGST Act, 2017].

In view of the aforesaid provisions, in the given case, the relevant date for computing the period of 3 months (for filing the appeal to Appellate Authority) is 28th April (date of communication of order) and not 23rd April. Accordingly, an appeal can be filed by Mr. X to Appellate Authority within 3 months from the date of communication of order (28th April), i.e. 28th July.

Thus, Mr. X has filed the appeal within the time limit prescribed under the GST law.

(ii) The Commissioner may, by order, direct any officer subordinate to him to apply to the Appellate Authority within 6 months from the date of communication of the decision/

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order for the determination of such points arising out of the said decision/ order as may be specified by him.

The Appellate Authority can condone the delay in filing of appeal by 1 month if it is satisfied that there was sufficient cause for such delay [Section 107 of the CGST Act, 2017].

In the present case, the Commissioner directs his subordinate officer to file a review application with the Appellate Authority. The subordinate officer should have filed the said application till 3rd September (i.e. within 6 months from the date of communication of order). However, the subordinate officer filed the application on 23rd September, i.e. after the expiry of period of 6 months from the date of communication of order. Thus, in the given case, appeal has not been filed within the time limit prescribed under the GST law.

However, Appellate Authority can condone delay in filing of appeal upto 3rd October (up to 1 month) if it is satisfied that there was sufficient cause for such delay.

17. (i) Section 10(1)(e) of the IGST Act, 2017 lays down that place of supply of goods supplied on board a conveyance like aircraft, train, vessel, or a motor vehicle, is the location where such goods have been taken on board. Thus, in the given case, the place of supply of the goods sold by Mr. Sahukaar is the location at which the goods are taken on board, i.e. New Delhi and not Jaipur where they have been sold.

(ii) As per section 11(a) of the IGST Act 2017, if the goods have been imported in India, the place of supply of goods is the place where the importer is located. Thus, in the present case, the pla ce of supply of the goods imported by Vidhyut Pvt. Ltd. is Noida, Uttar Pradesh.

(iii) As per section 12(8) of the IGST Act, 2017, the place of supply of services by way of transportation of goods, including by mail or courier provided to an unregistered person, is the location at which such goods are handed over for their transportation.

Since in the given case, the recipient – Aatmaram – is an unregistered person, the place of supply is the location where goods are handed to Gokul Carriers over for their transportation, i.e. Kanpur.

(iv) As per section 12(12) of the IGST Act, 2017, the place of supply of banking and other financial services, including stock broking services to any person is the location of the recipient of services in the records of the supplier of services. Thus, in the given case, the place of supply is the location of the recipient of services in the records of the supplier bank, i.e. New Delhi.

(v) As per section 13(4) read with section 13(6) of the IGST Act, 2017, where services supplied directly in relation to an immovable property are supplied at more than one location, including a location in the taxable territory, the place of supply is the location in the taxable territory. Since in the given case, the immovable pro perties

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are located in more than one location including a location in the taxable territory, the place of supply of architect service is the location in the taxable territory, i.e. Pune.

18. Computation of ITC available with Paridhi Ltd. in January

S. No.	Particulars	Amount (₹)
1.	Capital goods [Since depreciation has been claimed on the tax component of the value of the capital goods, ITC of such tax cannot be availed in terms of section 16 of the CGST Act, 2017.]	Nil
2.	Goods purchased from Rupesh Enterprises [ITC in respect of goods not received cannot be availed (Section 16 of the CGST Act, 2017). Since the goods have been received in the month of April, ITC thereon can be availed in April and not January even though the invoice for the same has been received in January.]	Nil
3.	Cars purchased for making further supply [Though ITC on motor vehicles used for further supply of such vehicles is not blocked, ITC on goods destroyed for whichever reason is blocked (Section 17(5) of the CGST Act, 2017).]	Nil
4.	Goods used for setting telecommunication towers [ITC on goods used by a taxable person for construction of immovable property on his own account is blocked even when such goods are used in the course or furtherance of business (Section 17 of the CGST Act, 2017).]	Nil
5.	Goods purchased from Sumo Ltd. [ITC can be claimed provisionally in January since all the conditions necessary for availing the same have been complied with (Section 16 of the CGST Act, 2017). However, the claim will get confirmed only when the tax charged in respect of such supply has been actually paid to the Government.]	10,000
6.	Trucks purchased for delivery of output goods [ITC on motor vehicles used for transportation of goods is not blocked (Section 17(5) of the CGST Act, 2017).]	80,000
	Total ITC available with Paridhi Ltd.	90,000

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19. Computation of assessable value of the imported goods

	Japanese Yen
Cost upto port of exportation	5,00,000
Add: Loading charges at the port of exportation [Note-1]	1,25,000
Total in Japanese Yen	6,25,000
	₹
Total in Indian rupees @ ₹ 0.68 per Japanese Yen	4,25,000.00
Add: Commission paid to local agent of exporter [Note-3]	50,000.00
FOB value as per customs	4,75,000.00
Add: Freight charges from port of export to port of import in India [Note-1] [50,000 Japanese Yen × 0.68 = ₹ 34,000]	34,000.00
Add: Lighterage charges paid by the importer at port of importation [Note-1]	30,000.00
Add: Insurance charges @ 1.125% of FOB [₹ 4,75,000 × 1.125%] [Note-4]	5,343.75
CIF value	5,44,343.75
Assessable Value (rounded off)	5,44,344
Add: Basic customs duty @ 10% of ₹ 5,44,344 (rounded off) (A)	54,434
Add: Social welfare surcharge @ 10% of ₹ 54,434 (rounded off) (B)	5,443
Total	6,04,221
Add: Integrated tax @ 12% of ₹ 6,04,221 (rounded off) (C)	72,507
Total custom duty and integrated tax payable [(A) +(B) + (C)] (rounded off)	1,32,384

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) of the Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 (hereinafter referred to as CVR)]. Further, explanation to rule 10(2), *inter alia*, clarifies that cost of transport of the imported goods includes lighterage charges.

(2) Design and engineering work is includible in the assessable value only when the same is undertaken elsewhere than in India and necessary for the production of the imported goods [Rule 10(1) of the CVR].

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(3) Buying commission is not included in the assessable value [Rule 10(1) of the CVR]. Commission paid to local agent of exporter is includible in the assessable value since it is not buying commission.

(4) Since the insurance cost is not ascertainable, the same shall be added @ 1.125% of FOB value of the goods [Rule 10(2) of the CVR].

20. The quantum of anti-dumping duty is:

(i) margin of dumping

or

(ii) injury margin

whichever is lower.

Margin of dumping is the difference between export price and normal value of the imported article.

Injury margin is the difference between the fair selling price [non-injurious price (NIP)] due to the domestic industry and the landed value of the dumped imports.

Export price in relation to an article, means the price of an article exported from the exporting country or territory. KTU Limited has imported the goods at USD 180 per piece. Thus, export price is USD 180 per piece.

Normal value in relation to an article, means comparable price, in the ordinary course of trade, for the like article when destined for consumption in the exporting country or territory as determined in accordance with the rules. Since Country Z sell the like goods in its domestic market in the ordinary course of trade at USD 300 per piece, thus normal value in the given case is USD 300 per piece.

Fair Selling Price (FSP) [Non-Injurious Price] is that level of price, which the industry is, expected to have charged under normal circumstances in the Indian market during the period defined. Since the imported goods are sold in domestic Indian Industry @ USD 275 per piece, thus Fair selling price in the present case is USD 275 per piece.

Landed Value is taken as the assessable value under the Customs Act and the applicable basic customs duties except CVD, SAD and special duties. Landed value in the given case is USD 190 per piece.

In the given case, anti-dumping duty per piece is:

(i) Margin of dumping is USD 120 [USD 300- USD 180]

or

(ii) Injury margin is USD 85 [USD 275 – USD 190]

whichever is lower i.e. USD 85

Anti-dumping duty for 800 pieces (in rupees) = USD 85 × 800 pieces × ₹ 72

= ₹ 48,96,000.

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