

MAY 2018

Roll No.

**Final New Syllabus
Paper - 6 F**

Total No. of Case Study Questions

Multidisciplinary Case Study

Total No. of Printed Pages – 31

Time Allowed – 4 Hours

Maximum Marks – 100

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Handwritten signature/initials

Answers to questions are to be given only in English except in the case of candidates who have opted for Hindi Medium. If a candidate who has not opted for Hindi Medium, his/her answers in Hindi will not be valued.

The Question Paper comprises three case study questions. The candidates are required to answer any two case study questions out of three.

In case, any candidate answers extra question(s)/sub-question(s) over and above the required number, then only the requisite number of questions first answered in the answer book shall be valued and subsequent extra question(s) answered shall be ignored.

Wherever necessary, suitable assumptions may be made and disclosed by way of a note.

All your workings should form part of your answer.

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1. **Background**

You have recently joined as an Audit Partner in M/s. XYZ & Co., Chartered Accountants (“the Firm”) based out of Mohali which has a variety of clients in the Technology, Software and Media segments. All their clients are based out of Mohali and Chandigarh. One of the key clients of the firm is Superstar Group which has several subsidiaries and your Firm does the audit and taxation work for all these entities. You have been assigned to support the Lead Client Service Partner for the Super Star Group, Mr. Madhav Mahajan, Partner, in the audit of Rising Star Limited. You have been provided with the below information to facilitate your audit.

Company Information

Rising Star Limited (the Company), which is a subsidiary of Super Star Limited, a Public Company (unlisted), was incorporated on 1st February, 2007 under the Indian Companies Act, 1956. It specializes in the business of developing graphical images for its various clients spread across the world. The shareholding pattern of the Company as at 31st March, 2017 are as under :

Particulars	No. of Shares (in Lakhs)**	Total paid up Equity Share Capital (₹ in Lakhs).
Super Star Limited	45.00	450.00
Mr. Thomas Edison (as a nominee of Super Star Limited)*	32.50	325.00
Mrs. Morgrate Edison (as a nominee of Super Star Limited)*	22.50	225.00
Total	100.00	1000.00

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*The Company has complied with the requirements of the Companies Act, 1956/2013 with respect to taking note of/filing the beneficial interest of Super Star Limited in the Company with the Registrar of Companies.

**Face Value of ₹ 10 each.

Whilst the Company was doing well in the initial periods, due to global recession in this segment, the business performance has gone South recently.

The Finance Director of the Company, Mr. Mangesh has requested the Statutory Auditors, M/s. XYZ & Co; Chartered Accountants to take up the audit and issue the audit report before the Board meeting scheduled in the month of June, 2017 based on which certain critical decisions impacting the future operations of the Company would be taken including a probable merger. The CEO of the Company, Mr. Stanley is in active discussion with the parent company and the Board of Directors. This information is proposed to be kept confidential as at this stage.

(A) **Key financial data as per Management Information provided for Audit**

The Company has also provided you with the management prepared financial statements for your audit. You have taken charge of this engagement and requested Ms. Manasa Maheswari, the Audit Manager to support you on this engagement.

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The key Financial highlights of the Company as at 31st March, 2017 as per the Management prepared financial statements are as under :

₹ in Lakhs

Particulars	As at 31 st March, 2017	Particulars	For the year ended 31 st March, 2017
Equity Share Capital	1,000	Revenue-Net	4,255
Capital Reserve (not arising on amalgamation)	250	Profit (Loss) After Tax	(124)
General Reserve	125	Operating Cash Flows	(452)
Profit & Loss Account	(238)	Investing Cash Flows	(230)
Long Term Borrowings from the Parent Company	20	Financing Cash Flows	923
Net Current Assets	(14)	Extra-ordinary Income	223
Cash & Cash Equivalents as at 1/4/2016 (excluding restricted cash and bank balances)	32	Deferred Tax Income	10
Bank Borrowings	12	Tax paid on Sales Revenue	12
Off Balance Sheet exposure in the form of Contingent Liabilities to the extent not paid and not provided for	122	Interest Expense	22

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(B) Information reported by the Audit Engagement Team :

The Engagement Team lead by Ms. Manasa Maheshwari has reported the following matters to you based on their field audit :

- (1) No physical verification of the assets was carried out during the year ended 31st March, 2017 and the same was due only in the ensuing year ending 31st March, 2018 as per the management policy approved by the Board which was assessed to be acceptable from the audit point of view at the time of policy formulation.
- (2) There was no disclosure of outstanding Letter of Credits (LCs) opened for import of certain assets from USA under contingent liabilities in the financials prepared by the Company amounting to ₹ 55 Lakhs.
- (3) Gratuity liability was not provided for employees who have joined the Company during the past 3 years, the aggregate amount of which would be ₹ 12.50 Lakhs on the basis that they are yet to complete the stipulated minimum years of service.
- (4) Certain computers were received from the parent company free of cost, the value of which is ₹ 0.23 Lakhs and no accounting or disclosure of the same has been made in the notes on accounts.
- (5) The loan availed from Chevy Chase Bank remained outstanding to the extent of ₹ 12 Lakhs excluding the penal interest charged by the bank amounting to ₹ 0.23 Lakhs for default in repayment for 2 quarters, pending to be accounted by the Company. The Management has also informed that this is not an information to be disclosed in the financial statements and does not have any bearing on the reporting of Auditors either.

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- (6) TDS receivable as per books is more than the cumulative balance as per Form 26AS by ₹ 14.50 Lakhs. No valid explanation was made available for the difference amount.
- (7) The Company has not provided for any tax expense in the books of accounts due to tax losses. The Company has recognized deferred tax asset on the unabsorbed business losses based on management assessment.
- (8) The Company follows the method of providing depreciation as per Section 123 of the Companies Act, 2013 using the useful lives prescribed as per Schedule II of the Companies Act, 2013. It has provided depreciation on computers which are used during all the 3 shifts using the rates stipulated for continuous process plant since these assets are used for 24 hours (3 shifts).
- (9) The amount of restricted bank balances as at 1-4-2016 and 31-3-2017 was ₹ 120 lakhs and the Company does not believe the same as qualifying for disclosure under Cash and Cash Equivalents.

(C) Review of Board Minutes

Whilst the Audit team has identified various matters, they need your advice to conclude on the same. You have asked them to review the Board minutes and other secretarial/regulatory records based on which the following additional matters were brought to your attention :-

- (10) The long term borrowings from the parent has no agreed terms and neither the interest nor the principal has been repaid so far.

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- (11) An amount of ₹ 1.22 Lakhs has been paid under protest against certain tax claims under dispute where the Company believes it has a fair chance and hence not provided for in the financial statements nor was it disclosed as contingent liabilities. During the discussions, the Company has also mentioned that since they have not provided for the same, this would not be an item in the Companies (Auditor's Report) Order, 2016 (CARO, 2016) reporting by the Auditors as disputed dues.
- (12) The Company is in the process of selling its office along with the freehold land available at Chandigarh and is actively on the lookout for potential buyers. Whilst the same was purchased at ₹ 25 Lakhs in 2008, the current market value is ₹ 250 Lakhs. This property is pending to be registered in the name of the Company, due to certain procedural issues associated with the Registration though the Company is having a valid possession and has paid its purchase cost in full. The Company has disclosed this amount under Fixed Assets though no disclosure of non-registration is made in the notes forming part of the accounts.
- (13) An amount of ₹ 3.25 Lakhs per month is paid to M/s. WE CARE Associates, a partnership firm, which is a 'related party' in accordance with the provisions of the Companies Act, 2013 for the marketing services rendered by them. Based on an independent assessment, the consideration paid is higher than the arm's length pricing by ₹ 0.25 Lakhs per month. Whilst the transaction was accounted in the financial statements based on the amounts paid, no separate disclosure has been made in the notes forming part of the accounts highlighting the same as a 'related party' transaction.

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Ms. Manasa Maheshwari, your Audit Manager has reported that she had asked for certain information relating to another 'related party' transaction (quantum likely to be about ₹ 47 lakhs) and the CFO has refused to provide the same since the same is perceived to be confidential and cannot be shared with Auditors.

- (14) The Internal Auditor of the Company has identified a fraud in the recruitment of employees by the HR department wherein certain sums were alleged to have been taken as kick-back from the employees for taking them on board with the Company. After due investigation, the concerned HR Manager was sacked. The amount of such kickbacks is expected to be in the range of ₹ 12 Lakhs.
- (15) Right International Inc, has served a legal notice on the Company claiming ₹ 250 Lakhs for patent infringement and the Company has challenged the notice through its legal counsel. An independent legal opinion obtained on this matter suggests that the possibility of a cash outflow is more likely than not under the existing legal framework/available evidence as made available to the legal counsel.
- (16) The remuneration for the auditors has been fixed by the shareholders as a fixed sum and a percentage based on the profitability of the Company.
- (17) CEO of the Company, Mr. Stanley has put forward a proposal to pay dividends to the shareholders notwithstanding the current financial condition. He proposes to manage the cash flows by borrowing from the bank. He would also like to provide for the same in the financial statements for the year ended 31st March, 2017 on approval by the Board.

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- (18) The Management has informed that it feels that the market conditions will improve and the Company would be totally profitable in the next 3 years' time and expects new orders/higher revenues in the coming years to fuel higher profitability. During discussions on this topic, Mr. Stanley informed that whilst there are no firm contracts/projects that are available on hand to demonstrate, Management is fully aware of their business environment and their assessment can be taken as sacrosanct.

(D) **Findings based on File Review**

After a careful consideration of the matters reported by the engagement team, you have also reviewed the financial statements, audit working papers and noted the following additional matters for your conclusion and overall assessment;

- (19) An amount of ₹ 0.25 Lakhs paid to M/s. Hemamalini Associates, Chartered Accountants (a network firm of XYZ & Co., Chartered Accountants, where Mr. Madhav Mahajan is also a partner) towards various tax representation services has not been disclosed anywhere in the financial statements separately.
- (20) Certain unclaimed dividends amounting to ₹ 38 Lakhs pertaining to the prior periods beyond 7 years have been written back to the Statement of Profit & Loss under 'Other income'.
- (21) The Market to Market Loss of ₹ 13.74 Lakhs as at 31st March, 2017 on the outstanding forward contracts pertaining to highly probable transactions which have an original tenure of 3 years is proposed to be accounted by the Company as and when the settlement transaction is scheduled which is likely to happen in December 2018. The Company has not adopted hedge accounting consistently.

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(22) Extraordinary income arose from the gain on sale of freehold land at Kurukshetra.

(23) The Finance Director of the Company was also enquiring about the applicability of Indian Accounting Standards (IND AS) for the Company. He said that considering the parameters mentioned for applicability of IND AS and the Company's turnover, profit after tax and net worth for the last financial years, it is not applicable for the entity for the financial year 2016-17 and, hence, existing Indian GAAP has been considered by the Company in the preparation of its financial statements. He has also asked you to confirm the same.

(24) During your interactions with Mr. Mangesh, the Finance Director of the Company, he has indicated that he would expect a clean opinion on the financial statements and reference to matters which would have negative perception could be ignored considering the possibility of the merger under evaluation. He has also indicated that he does not expect any further adjustments to the financial statements since the same has been shared with the bankers already.

Based on the above information, you have to provide your inputs on the below aspects to your Lead Client Service Partner to assist him in forming his opinion.

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PART - A

Answer the following questions with reasons in short and appropriate technical references.

- (1) Whether Superstar Limited needs to consolidate the financial statements of Rising Star Limited under the Companies Act, 2013 ? **2**
- (A) No
(B) Yes, for 100%.
(C) Yes, but only to the extent of 45%.
(D) Consolidation requirement itself is not applicable under the Companies Act, 2013 being an unlisted entity.
- (2) What is the Net Worth of the Company as per the Management prepared financial statements as at 31st March, 2017 ? (₹ in Lakhs) **2**
- (A) 887 (B) 1137
(C) 1015 (D) 1125
- (3) What is the total amount of contingent liabilities of Rising Star Limited as at 31st March, 2017 ? (₹ in Lakhs) **2**
- (A) 122 (B) 178.22
(C) 123.22 (D) 213.22
- (4) What is the amount of Cash and Cash Equivalent to be disclosed in the Cash Flow Statement as at 31st March, 2017 ? (₹ in Lakhs) **2**
- (A) 241 (B) 723
(C) 149 (D) 273

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- (5) The amount at which the Chandigarh property to be accounted in the books of account as at 31st March, 2017 is _____ (₹ in Lakhs) **2**
- (A) 250 (B) 275
(C) 25 (D) 225
- (6) Do you think that the “Deferred Tax Asset” recognition on the unabsorbed business losses is appropriate ? **2**
- (A) Yes
(B) No
(C) Yes, since it is based on Management assessment and the same is as per the AS 22.
(D) It depends/based on the decision to be taken by the CEO regarding the probable merger.
- (7) Whether gain on sale of land at Kurukshetra accounted as an extraordinary income is acceptable under the Companies Act, 2013 reporting framework ? **2**
- (A) Yes, it is appropriate.
(B) No, this may be accounted as an exceptional item.
(C) No, this should be accounted as ‘income from operations’.
(D) It depends on the decision to be taken by the CEO regarding the probable merger.

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(8) Certain information considered as confidential by the Management for sensitive purposes can be rightfully denied to the auditors.

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- (A) Yes, for valid reasons as assessed by the Management.
- (B) No, it cannot be denied; else this would result in possible scope of making audit qualifications for the Auditors.
- (C) Can be denied after taking the consent from the Board.
- (D) Can be denied after informing the Regulators.

(9) In view of the discussions by the Finance Director with you, reference to unfavourable or qualified answers in the Companies (Auditor's Report) Order, 2016 (CARO, 2016) where applicable may be avoided.

2

- (A) Yes, based on the request from the client.
- (B) No, where required, due disclosure as required under the Companies Act, 2013 needs to be made.
- (C) Considering the merger possibility, such matters may be reported to the Board and can be avoided in CARO, 2016.
- (D) Entire reporting under CARO, 2016 may be dropped.

(10) Whether Auditors' remuneration as proposed by the shareholders is acceptable to you ?

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- (A) Yes
- (B) No
- (C) Permissible since the shareholders have approved the remuneration.
- (D) Cannot decide based on available information.

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PART - B

Answer the following :

- (1) Are there any matter(s) that need to be reported with unfavourable response under the Companies (Auditor's Report) Order, 2016 (CARO, 2016) ? If so, explain the same with relevant rationale. **8**

- (2) Summarise the material misstatements, if any, on the management prepared financial statements which could impact the true and fair view of the financial statements. Please provide the basis for your assessment briefly. **8**

- (3) What are the disclosure deficiencies, if any, in the Management prepared financial statements that could impact the true and fair view of the financial statements ? Please provide the basis for your assessment briefly. **6**

- (4) Provide a brief summary of items to be reported to those in-charge of governance, where applicable, based on your audit findings for Rising Star Limited, duly considering the Auditing Standards and the applicable provisions of the Companies Act, 2013. **4**

- (5) As an auditor of Rising Star Limited, state the matters to be reported under Rule 11 of the Companies (Audit and Auditors) Rules, 2014 ? What are those matters and how would you report them ? **4**

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2. Background

New Gen Toys and Clothing Limited, is a reputed company which is engaged in two businesses viz.

- (i) Manufacture of Soft Toys.
- (ii) Fabrics and Cloth business through textile showrooms in various cities and towns.

The manufacture of soft toys started with effect from 01-04-2016 and that of fabric and cloth business with effect from 01-04-2017.

Separate books of accounts as are legally required to be maintained are maintained for the aforesaid businesses. The books of accounts maintained do comply with all significant accounting policies, accounting on the basis of historical cost convention, compliances of Accounting Standards, alignment with generally accepted accounting principles, accrual system of accounting and on the basis of going concern. The books of accounts are also duly audited by a reputed firm of Chartered Accountants. The income tax assessments is also completed up to Assessment year 2016-'17 and there are no income tax or any other statutory dues payable by the company.

The Company's founder and Managing Director has resigned from his position and has inducted in his place his young son, aged 24 years, a research scholar from Harvard University as the new Managing Director after due approval of the Board as well as the shareholders at the annual general meeting of the Company held on 29-09-2016.

The new Managing Director of the Company is desirous of knowing various facets of the provisions of the Income Tax Act, 1961 with special reference to the relevant Sections of the said Act for adopting certain tax planning measures and for other business decision making including, the essential

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conditions for claiming exemption for newly established units in Special Economic Zones. In this context, he has approached you in the capacity of a Chartered Accountant in practice and also being an expert in the field of direct taxation and has offered you a professional fee. The new Managing Director has provided you with the following information in relation to the soft toys manufacturing business as well as the fabrics and cloth business for the year ended March 31, 2018 and seeks your advice to the questions at the end.

SOFT TOYS MANUFACTURING BUSINESS :

Net Profit as per Statement of Profit and Loss – ₹ 36,50,000

Items debited/credited to Statement of Profit and Loss :

- (i) Bad debts written off in previous year 2016-'17 ₹ 2,50,000 of which ₹ 1,80,000 was recovered in July, 2017.
- (ii) CSR expenditure by way of putting traffic signal outside the factory ₹ 2 lakhs.
- (iii) Donation to registered political party ₹ 70,000. Of this, paid by cash ₹ 30,000 and by cheque ₹ 40,000.
- (iv) Amount received as 30% share in an AOP ₹ 1,20,000. The AOP is engaged in the business of plastic mould manufacture.
- (v) Long term capital gain on sale of unlisted shares (without indexation) ₹ 50,000.
(Note : With indexation, the long-term capital gain is ₹ 30,000.)
- (vi) Dividend from domestic companies received during the year ₹ 11,00,000.

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- (vii) ₹ 20 lakhs was paid to a founder director by way of goodwill, who resigned from the Company on 30-04-2017. No tax was deducted at source on the said payment.
- (viii) Depreciation debited ₹ 13,50,000.
- (ix) Deferred tax liability debited to profit and loss account ₹ 3 lakhs.
- (x) Royalty ₹ 10 lakhs received in respect of patent developed and registered in India.

FABRICS AND CLOTH BUSINESS :

Net profit as per Statement of Profit and Loss – ₹ 26,50,000

Items debited/credited to Statement of Profit and Loss :

- (i) Income tax debited ₹ 6,60,000.
- (ii) Online advertisement charges paid to a foreign company ₹ 2,00,000.
No tax was deducted at source.
- (iii) Depreciation debited to statement of profit and loss ₹ 24,00,000
(includes ₹ 8 lakhs on account of revaluation of assets).
- (iv) Interest on term loan paid during the year ₹ 8,50,000. It includes ₹ 3,20,000 of the financial year 2012-13 which was disputed before the Court and the Court decreed the case in November, 2017.
- (v) Group Gratuity Scheme was approved by Commissioner of Income Tax during the year and ₹ 21 lakhs was paid to LIC of India by way of its contribution.
(Note : The payment to employees during the year from the scheme ₹ 3 lakhs.)
- (vi) Provision made for decrease in value of showroom buildings due to wear and tear ₹ 7,00,000.

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Additional information :

- (i) During the year, for the Fabric and Cloth business division, the Company bought generators for ₹ 40 lakhs and for which it got ₹ 5 lakhs by way of subsidy from the Government. This was credited to capital reserve. The Company paid ₹ 3 lakhs by cash and balance ₹ 32 lakhs through net banking channel to the supplier. Though generators were acquired in August, 2017 they were put to use only from 01-12-2017.
- (ii) The Company has not considered interest due of ₹ 2,50,000 from customers of toys division for the delayed payment of bills by them.
- (iii) Eligible depreciation under Section 32 in respect of all tangible assets (except generators) is ₹ 87,50,000.
- (iv) The Company earned ₹ 2,20,000 by way of sale of carbon credit. This has been credited to capital reserve.
- (v) The Company has unabsorbed loss of ₹ 12,50,000 of the assessment year 2016-17 relating to Soft toys manufacturing business. The return was however filed before the 'due date' specified in Section 139(1).
- (vi) During the year, the Company paid ₹ 4 lakhs to a Director who gave guarantee for securing overdraft facility obtained by Soft toys manufacturing division. This amount is debited to general reserve of the Company.
- (vii) The Company employed 30 workers for 9 months during the year 2017-18 by paying salary of ₹ 15,000 per month. The number of employees as on 31-03-2018 has increased by the said recruitment as against the number of employees as on 31-03-2017.

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PART - A

Choose the most appropriate alternative for the following and justify the same with reasons in brief :

- (1) The Company is eligible to claim depreciation in respect of goodwill at _____ %.
- (A) 25 (B) 15
(C) 100 (D) NIL
- (2) The Company is liable to pay equalization levy at _____ % in respect of online advertising paid to non-resident.
- (A) 10 (B) 20
(C) 8 (D) 6
- (3) The monetary limit for salary per month to new employee for the purpose of claiming deduction under section 80 JJAA under the appropriate provision of Chapter VI-A is
- (A) No limit (B) ₹ 25,000
(C) ₹ 15,000 (D) ₹ 10,000
- (4) The tax liability due to sale of carbon credit would be
- (A) ₹ 67,980 (at 30.9%) (B) ₹ 45,320 (at 20.6%)
(C) ₹ 22,660 (at 10.3%) (D) NIL (exempt)
- (5) Amount paid to director for giving guarantee for the Company to secure overdraft facility is chargeable to tax in the hands of Director as
- (A) Deemed dividend (B) Dividend
(C) Income from other sources (D) Directors' fee

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- (6) In the case of online advertisement charges paid to domestic company, the amount liable for disallowance for non-deduction of tax at source would be : 2
- (A) 10% i.e. 20,000 (B) 30% i.e. 60,000
(C) 100% i.e. 20,000 (D) NIL
- (7) For a domestic company, the long-term capital gain on sale of unlisted shares is taxable at 2
- (A) 10% (B) 15%
(C) 20% (D) Fully exempt.
- (8) Interest on term loan is deductible when it is 2
- (A) Paid on or before the 'due date' specified in Section 139(1)
(B) Paid before the 'end' of the previous year.
(C) Paid within 15 days from the date it becomes due.
(D) Due as per the agreement.
- (9) When the assessee has speculation loss, it is eligible for carry forward and set off in the subsequent _____ assessment years. 2
- (A) 4 (B) 6
(C) 8 (D) infinite
- (10) The income of the AOP in which the Company is a member is chargeable to tax at _____ (tax rate). 2
- (A) Individual rate (B) Maximum marginal rate
(C) 20% (D) NIL

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PART - B

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| (a) Compute the business income of soft toys manufacturing business for the Assessment Year 2018-19. | 7 |
| (b) Compute the business income of fabrics and cloth business for the Assessment Year 2018-19 | 8 |
| (c) Compute total income of the Assessee for the Assessment Year 2018-19. | 5 |
| (d) Compute the book profit tax under Section 115JB on the assumption that the consolidated figures of two divisions were given in Schedule III to Companies Act, 2013. | 5 |
| (e) What are the essential conditions for claiming exemption for newly established units in Special Economic Zones ? | 5 |

3. **Background**

You are a leading Mergers and Acquisition (M & A) Practitioner advising corporates on the implications of mergers and amalgamations covering various aspects *inter alia* on the legal, business, and corporate and tax related matters.

Your Client, Magma Automobiles Limited (the Company), has reached out to you for seeking your advice with respect to their proposal to consider some restructuring in the group in a more robust manner. They have requested you to join their internal brain storming session organized to discuss and decide on the way forward. This meeting will be attended by Yasin Malik, Managing Director, Anirudh, Chief Financial Officer, Aswini, President - Taxation and Mohan Rangarajan, Company Secretary. They have also requested their Financial Controller Subha to join the session. You have agreed to participate and provide your insights in the session.

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You will be provided with the brief background of the Company and matters raised by various participants for which your advice will be required. Please note that the Company will decide the way forward based on your advice and, hence, your valuable guidance would be extremely crucial for the ultimate decision making by the Board/Shareholders.

Corporate Information

Magma Automobiles Limited "Magnum" is a listed Company incorporated under the Companies Act, 1956. The shares of the Company are listed in the Bombay Stock Exchange. It specializes in the manufacture of luxury cars and has its plants located at Hyderabad and Mumbai. It also has its own captive power plant at Hyderabad. The shareholding pattern of the Company as at 31st March, 2015 is as under :

Particulars	No. of Shares	Amount in ₹ Lakhs	%
Public shareholding	270,000	270	27%
Promoters	610,000	610	61%
Institutional Investors	120,000	120	12%
Total	1,000,000	1,000	100%

The Company has been doing extremely well and its Turnover and Profit After Tax for the past 3 years is given below :

Year	Turnover (Amount in ₹ Lakhs)	Profit After Tax (Amount in ₹ Lakhs)
FY 2015	47,021	2,915
FY 2014	50,406	3,578
FY 2013	51,918	3,062

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The Company was promoted by Rahman Malik, father of Yasin Malik who has set up several ventures as a first generation entrepreneur. Whilst there are 15 such companies promoted by him in different segments which are operational, 'Magnum' is the flagship company of the Malik group (Maliks). 'Magnum' went public in the year 2005 and the shares were oversubscribed by 2.12 times at that time. The Company has been paying dividend to its shareholders consistently and is having a healthy price trend in the Bombay Stock Exchange during the past several years.

The Company has surplus cash and the cash accretion is generally invested in fixed deposits and mutual funds.

The Proposal

Yasin Malik has put forward a proposal to merge 'Magnum' with an unlisted entity 'Yamuna' Fitting Works Limited, ("Yamuna") through an approved restructuring route considering certain business reasons. He has requested the Chief Financial Officer to explain the financial and other details of 'Yamuna' to kick start the discussions further. He has also preferred to go for a capital reduction of 'Yamuna', if permissible under the law along with the Scheme.

Information Provided by Anirudh, CFO

'Yamuna' which is an entity promoted by the Maliks, is specializing in the manufacture of engineering products for vehicle manufacture. It was incorporated in 2010 and its plant is located at Pune. Due to various external conditions, 'Yamuna' is not doing well and has recorded huge losses accumulated year on year. Details of shareholding pattern of 'Yamuna' as at 31st March, 2015 is as under :

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Particulars	No. of Shares	Amount in ₹ Lakhs	%
Promoters (same Shareholders as that of 'Magnum')	90,000	90	90%
Friend and Relatives	10,000	10	10%
Total	100,000	100	100%

The number of shares mentioned above have increased every year by 7,000 shares for the last 7 years continuously, but the proportion of shareholding has remained the same.

The key financial data of 'Yamuna' is as under :

(₹ in lakhs)

Particulars	As at 31st March, 2015	As at 31st March, 2014	As at 31st March, 2013
Equity Share Capital	100	93	86
Capital Reserve	25	25	25
General Reserve	42	42	42
Profit & Loss Account	(287)	(211)	(163)
Inter Corporate Deposit (ICD) from Magnum	20000	20000	20000
Net Current Assets	(364)	(193)	(213)
Bank Borrowings	10000	10000	10000
Revenue-Net	1822	2453	2697
(Loss)/Profit After Tax	(76)	(48)	(32)
Operating Cash Flows	(2674)	(1167)	(1234)
Investing Cash Flows	76	34	11
Financing Cash Flows	2936	1534	1432
Interest Expense	75	82	77

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Anirudh has highlighted the following significant matters relating to 'Yamuna' :

- 'Magnum' has lent an amount of ₹ 20,000 Lakhs to 'Yamuna' as an inter-corporate deposit for meeting various working capital requirements in the year 2012 which is being rolled over every 6 months since 'Yamuna' is not in a position to repay the loan as per the agreed tenure. It is also not servicing any interest and the amount of interest payable as per the terms is not recognised in the books of 'Magnum' in view of the uncertainties attached to revenue recognition.
- In addition, 'Yamuna' has also taken loans from Zomi Bank for ₹ 10,000 lakhs and the same has been guaranteed by 'Magnum'. Due to default in repayment, the bank has classified the loan provided to 'Yamuna' as a Non-Performing Asset. It has also taken certain steps to recover the amount by filing a winding up petition. 'Yamuna' is in the process of discussing One Time Settlement with the Bank through some third party funding arrangement. The gains arising out of one time settlement amounting to ₹ 2,000 lakhs has already been taken to Revenue on accrual basis in anticipation of the settlement.
- 'Yamuna' is dependent on couple of customers namely Magic Works and Perfection Precision Works. Whilst the operating level margins are positive, at net profit level, these arrangements are not profitable due to its limited size/complication involved in execution.
- Lack of adequate core working capital and higher power cost are the main reasons for the loss in 'Yamuna'.

- Whilst the plant of 'Yamuna' requires renovation, the same can be utilized for carrying out certain activities of 'Magnum' with some additional investment of about ₹ 1,000 lakhs.
- The accumulated business loss of 'Yamuna' as per tax is ₹ 4,500 lakhs and the unabsorbed depreciation loss is ₹ 1,200 lakhs.

Further Background of the Proposal

Yasin Malik added that it is apparent that 'Yamuna' is going through tough times and all the efforts made by the promoters to revive the entity has become futile and time has come now to fix the problem with the help of 'Magnum'.

He added that a due valuation of both the entities may be carried out and based on the swap ratio as determined by the Valuers, shares can be allotted to the holders of 'Magnum' in 'Yamuna'. He also wanted to understand the process involved under the Companies Act, 2013 listing agreement, as well as SEBI (LODR) Regulations, 2015 as well as other applicable regulations that are significant.

Key Matters raised by Aswini, President, Taxation.

Aswini has suggested that since 'Magnum' is a tax paying entity, through the merger, the possibility of setting off the carry forward losses of 'Yamuna' including the speculative losses, needs to be explored.

He also added that considering the financial position of 'Magnum' and 'Yamuna', based on the valuation, the merger could trigger a goodwill in the hands of 'Yamuna' which can also be considered for tax deduction.

He was skeptical about the acceptance of the scheme by the tax authorities in view of the involvement of the Group Company/related party. He wanted to know if the same would be permissible under the Companies Act, 2013.

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Inputs from Mohan Rangarajan, Company Secretary.

Mohan believes that this proposal is completely workable and infact the same needs to be mandatorily pursued through the fasttrack mechanism available under the regulatory framework. He further added that the ICD which remains as outstanding from 'Yamuna' will also be eliminated on merger and hence the issue of repayment also does not arise. He wanted some inputs on the various procedural formalities involved in getting the regulatory consent for the scheme.

Mohan also indicated that the creditors meeting is not required if the eligible conditions are satisfied.

Matters raised by Subha, Financial Controller.

Subha raised the issue of accounting for interest on the ICD. Further, Subha also raised the issue of ongoing settlement with the bankers and the potential impact of the same on this proposal. In addition, Subha raised the issue of the date of giving effect to the proposal in the books of account based on the scheme if approved by the appropriate authority.

Other matters raised during the session

It was agreed that the merger proposal will be pursued based on the scheme to be approved by the Board/Shareholders/other stakeholders/appropriate authority under the Companies Act, 2013 and other applicable legislation duly taking the required professional advise wherever required.

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PART - A

Based on the above information, please provide your suitable advice to your client to assist him in forming his opinion to the following questions in short and appropriate technical reference :

- (1) The proposal put forward by 'Magnum' would be best termed as 2
(A) Asset Sale (B) Amalgamation
(C) Slump Sale (D) None of the above
- (2) Capital Reduction of 'Yamuna' can be carried out along with the proposal of 'Magnum' to merge with 'Yamuna' if approved by all the stakeholders/appropriate authority. 2
(A) No
(B) Yes
(C) Permissible only under certain circumstances with the approval of Competition Commission of India.
(D) Permissible only with the consent of all the minority shareholders.
- (3) The Scheme, if approved, will be given effect to in the books of account on 2
(A) The date of the Order of the Appropriate Authority
(B) Appointed Date
(C) Financial year end in which the Order is received.
(D) The date on which the Order of the Appropriate Authority is filed with the Registrar of Companies.
- (4) On giving effect to the Scheme, Inter-company Loan provided by 'Magnum' to 'Yamuna' 2
(A) Will remain in the books of 'Yamuna'
(B) Will be squared off
(C) Will remain as a memorandum Entry
(D) Will remain only in the books of 'Magnum'

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- (5) Whether the proposal of 'Magnum' for the merger needs to be mandatorily pursued under fast track option ? **2**
- (A) Yes
- (B) Would vary on a case to case basis depending on the contents of the scheme.
- (C) Yes, if it involves capital reduction.
- (D) No
- (6) Whether the speculative losses carried forward by 'Yamuna' is available for set off against the profits and gains of business of 'Yamuna' post-merger ? **2**
- (A) Yes
- (B) No
- (C) Permissible if it is within the period of 8 years.
- (D) If the Scheme provides for such set off, the same would be permissible.
- (7) The accounting for the one time settlement benefit in the form of anticipated interest waiver by the Bank in the books of account of 'Yamuna' for the year ended 31st March, 2015 is appropriate. **2**
- (A) Yes, it is appropriate.
- (B) No, this should be accounted as an exceptional item.
- (C) No
- (D) Permissible since the entity is going through the merger proposal.

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- (8) Meeting of the Creditors cannot be dispensed with under any 2
circumstances under the Companies Act, 2013
- (A) Yes
- (B) No, it can be dispensed with under certain circumstances as stipulated under the Companies Act, 2013.
- (C) Dispensation is possible, if the scheme is approved by the shareholders.
- (D) Dispensation is not possible, if there is a loan taken from the Bank.
- (9) Additional amount of capital expenditure expected to be spent on 2
renovation of 'Yamuna' needs to be accounted in the books of account on
- (A) The Effective Date of the Scheme.
- (B) Date of filing the approved scheme with the Registrar of Companies.
- (C) The day on which the expenditure is incurred.
- (D) End of the financial year in which the order sanctioning the scheme was received.
- (10) Any Merger Scheme which involves 'related parties' would not be 2
approved under the Companies Act, 2013.
- (A) Yes
- (B) Permissible if the stipulated requirements of the Act including obtaining the consent from all the intended stakeholders is complied with
- (C) Permissible only when the 'related parties' sell off their holding to third parties.
- (D) Permissible with the sole approval of the Audit Committee.

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PART - B

Answer the following :

- (a) What are the risk factors to be considered in the matter of merger of 'Magnum' with 'Yamuna' ? **5**
- (b) What are the ideal considerations for a reverse merger and state its relevance to 'Magnum' ? **5**
- (c) If the Reverse Merger scheme is duly approved under the Companies Act, 2013 evaluate the impact of the same under the Income Tax Act, 1961 for 'Yamuna'. **10**
- (d) Who are the stakeholders impacted because of the Reverse Merger proposal to whom the required notices have to be sent/consent to be taken before the sanctioning of the Scheme ? **5**
- (e) Are there any other options available instead of Reverse Merger Option ? If so, please explain the same with your rationale. **5**
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