

**Final New Syllabus**

**Paper - 6 F**

**Multidisciplinary Case Study**

MAY 2022

Roll No. ....

Total No. of Case Study Questions – 5

5/15  
25/05/2022  
5:30 PM

Total No. of Printed Pages – 23

Time Allowed – 4 Hours

Maximum Marks – 100

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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 five case study questions. The candidates are required to answer any **four** case study questions out of five.

Answers in respect of Multiple Choice Questions are to be marked on the OMR answer sheet as given on the cover page of the answer book.

Answer to MCQs, if written inside the descriptive type answer book, will not be evaluated.

Candidate should answer the Case Study Questions as selected by them

i.e. MCQ as well as descriptive Questions of the same Case Study

Question in totality. Candidates are not permitted to answer MCQs of one Case Study Question and the descriptive questions of another Case Study Question and vice-versa.

Candidate may use calculator

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**CASE STUDY – 1**

**Facts of the Case**

PS Limited (PSL) is manufacturers for Electric circuits, boards and switchgear. Its products are sold to customers through retail network and its distributors are situated across the country. The company also exports these products but only to a few countries worldwide. The company is also engaged in taking projects on turn-key basis. The company has plants in Himachal Pradesh, Tamil Nadu, Maharashtra and Andhra Pradesh.

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The company has a high reputation amongst its stakeholder's viz. shareholders, workers and customers. The attrition rate of employees is also very low compared to other players in the market. The main reason for such low rate is because the company believes in 'family' concept of our country and treats the employees as part of the large family and has several schemes to keep their morale high. Employees are also part of decision making and they are also made to share profit of the company according to a well-defined profit-sharing plan. The terms of the profit sharing plan are as under :

- (a) The profit sharing pool will be the least of the following three limits:
  - (i) 40% of earning before taxes, to the extent it is in excess of the minimum acceptable target profit margin;
  - (ii) 0.65% of gross revenue
  - (iii) absolute amount of ₹ 3.00 Crores
- (b) Minimum acceptable target profit will be equivalent to the average of last three year's net operating profit of industry.
- (c) The individual employee will be entitled to share profit in the pool in proportion to his salary to the total salary of all employees.

The information for the year 31<sup>st</sup> March, 2021 is as under :

1. The earning before tax of PSL is ₹ 50 Crores.
2. Net Operating Assets employed by PSL is ₹ 130 Crores.
3. During the year, Gross revenue of PSL is ₹ 400 Crores.
4. Total Salary to employees during the year was ₹ 45 Crores.

Industry's average net operating profit of last 3 years is 10% of net operating assets.

During the year ended 31<sup>st</sup> March 2021, PSL (the company) ordered two aircrafts for convenience of visit by higher officials to its various plants for a total price of ₹ 5 Crores each, on 1<sup>st</sup> February 2021. These aircrafts will be delivered in September 2023. The company has made a down payment of 50% for each aircraft at the time of placing the order on 1<sup>st</sup> February 2021. The balance amount is payable on delivery. The advance paid by the company has fully been funded by bank borrowings taken on 1<sup>st</sup> February

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- 1.3. The capitalisation of borrowing cost for purchase of aircraft should commence on :
- (a) 1<sup>st</sup> February 2021.
  - (b) September 2023 when the aircrafts are delivered.
  - (c) 30<sup>th</sup> September 2021 when the manufacturing of aircraft is started.
  - (d) 1<sup>st</sup> April 2021.
- 1.4. What amount of trade payables shall be separately disclosed in the Balance Sheet as required by the amended Schedule III of the Company's Act 2013 ?
- (a) ₹ 40 crore (Outstanding for more than 6 months).
  - (b) ₹ 130 crore (Dues of Micro and Small Enterprises).
  - (c) ₹ 180 crore (Dues of Micro, Small and Medium Enterprises).
  - (d) No separate disclosure is required.
- 1.5. NBV Associates should report the fraud to/in :
- (a) Audit Committee/ Board of Directors of PS Limited and in Auditor's Report.
  - (b) Shareholders of PS Ltd and no further reporting.
  - (c) In Auditor's Report only.
  - (d) Central Government and in Auditor's Report.

**Descriptive Questions**

- 1.6. Explain profit sharing plan, as performance management tool and group incentive plan. 3
- 1.7. Define qualifying asset for capitalising the borrowing cost and explain when the capitalisation should commence and cease. 5
- 1.8. Explain "Variable Consideration" and how it will be accounted for in terms of Ind AS. 7

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**CASE STUDY -2**

**Facts of the Case :**

TP Limited is a company which deals in various commodities. Previous year the company achieved a turnover of ₹ 1000 Crores. The paid up equity capital of the company is ₹ 15 Crores. The Company is a listed public company. The company has its offices in Mumbai, Kolkata, Chennai and Delhi. The Company trades in Commodity "X" which is mainly dealt at Mumbai Market. However, the company also obtains the information from Kolkata Market regarding this product. The company has gathered the following information/data in this regard :

	Market Mumbai	Market Kolkata
Volume (annual, in millions ₹)	30	120
Transactions (per day)	25	65
Price (at period end, ₹)	110	107
Transport costs (₹)	(8)	(4)
Potential fair value (₹)	102	103
Transaction costs (₹)	(3)	(5)
Net proceeds (₹)	99	98

M/s YM Associates, Chartered Accountants are Auditors of the Company. The company has an Audit Committee and a Risk Management Committee in place. Both the committees met twice during the year. Further, in one of the meetings of Audit Committee conducted during the FY 2020-21, the internal control system and auditor's report of TP Ltd. were discussed. Mr. Yasvardhan, audit partner was also present at one of the meeting and the Audit Committee called for the comments of Mr. Yasvardhan if any. Certain important decisions regarding the changes in the internal control system were duly taken by majority voting.

The Company is having Mr Tara Prasad as its Managing Director and Ms. Julie as Company Secretary. The Company has appointed CA. Vinod as CFO who is also CFO in another unlisted company. Ms. Julie resigned from Company Secretary's post on 1<sup>st</sup> January 2021.

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MX Limited is an associate of TP Limited. NCLT has passed an order for conducting meeting of the members for considering the scheme of compromise and arrangement, the necessity of which has arisen on account of certain disputes with the creditors of the company. Company has sent notice of the meeting to all its 1000 members holding total 30 lakh shares. On the date of meeting, only 580 members holding 18 lakh shares attended the meeting and 400 members holding 14 lakh shares voted in favour of the scheme of compromise and arrangement and remaining voted against the scheme.

**Provide the correct option to the following Questions**

**2 × 5 = 10**

**Multiple Choice Questions**

- 2.1. Is the company justified in holding meeting of its Audit Committee and Risk Management Committee twice in the F.Y. 2020-21 ?
- (a) Yes, the company is justified as the meetings of both the committees were held as per the company's requirement and the important matters were duly discussed and conducting a meeting involves expense and when all the matters were discussed in two meetings it is wise on the part of the company that they did not hold more meetings.
  - (b) No, the company is not justified in holding two meetings of both the committees as the Audit Committee should meet at least four times in a year and Risk management committee can meet once in a year.
  - (c) The company is not justified in holding two meetings of the Audit Committee as an audit committee should meet at least four times in a year; however, the company can hold two meetings of Risk management committee.
  - (d) The company is justified as it is at the discretion of the Board of Directors to hold the meetings of the various committees of the company as per the company's requirement to discuss the matters.

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2.2. With respect to the meeting of Audit Committee attended by Mr. Yasvardhan, what all rights can be exercised by Mr. Yasvardhan ?

- (a) Mr. Yasvardhan has right to be heard and to vote in the meeting of Audit Committee of TP Ltd when it considers the auditor's report.
- (b) Mr. Yasvardhan has right to vote in the meeting of Audit Committee of TP Ltd when it considers the auditor's report.
- (c) Mr. Yasvardhan, being statutory auditor does not have right to be heard and to vote in the meeting of Audit Committee of TP Ltd even if it considers the auditor's report. Such rights vest with the internal auditors of the company.
- (d) Mr. Yasvardhan has right to be heard in the meeting of Audit Committee of TP Ltd when it considers the auditor's report but shall not have right to vote.

2.3. The fair Value of Commodity "X" will be

- (a) ₹ 102
- (b) ₹ 103
- (c) ₹ 99
- (d) ₹ 98

2.4. TP Limited has violated the provisions of the Companies Act 2013 by appointing CA. Vinod as its CFO :

- (a) There is no violation of law as whole-time key management personnel can hold office in more than one company even if it is not its Subsidiary company.
- (b) Yes, there is violation of company law as whole-time key managerial personnel shall not hold office in more than one company except in its subsidiary company at the same time.
- (c) The appointment of CFO is not a mandatory requirement; hence, appointment of CFO who is also CFO in other company does not violate the provisions of law.
- (d) There are 2 other whole-time key management personnel and therefore, if one person is holding office in other company, does not violate the provision of law.

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- 2.5. The vacancy created by resignation of Ms. Julie shall be filled :
- (a) By the board at a meeting of the board within 6 months from the date of such vacancy.
  - (b) By the Managing director within 6 months from the date of such vacancy.
  - (c) By the shareholders in its meeting within 6 months from the date of such vacancy.
  - (d) At will of the board of directors, there is no time limit to fill the vacancy.

**Descriptive Questions**

- 2.6. Explain the constitution of Audit Committee as per the provisions of the Companies Act, 2013 and SEBI (LODR) Regulations 2015. 4
- 2.7. Explain the term 'Fair Value' in terms of Ind AS. Also define the term 'Principal Market' and how it is determined. 3
- 2.8. In terms of case study given, explain whether the scheme got proper approval of the members or not. Also explain the procedure for compromise or arrangements with creditors or members as per the provisions of the Companies Act 2013. 8

**CASE STUDY-3**

**Facts of the Case :**

BMV LLP, a firm of Chartered Accountants has various divisions/verticals. Each division is headed by a Chartered Accountant who is qualified and has done specialised course. Each head is known for his knowledge and integrity amongst professionals and in Industry. BMV is also known as financial analyst as well as consultant for mergers and acquisitions. The firm has been approached by its clients to render professional advice on several issues highlighted in the under mentioned case scenarios :-

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**CASE SCENARIO – 1**

Tame Limited is a company engaged in telecommunication services and presently its major presence is in North India. The company wants to expand its business in South. The company has got two options. One is to expand itself by opening its own network which will take substantial time and efforts and results will also be not fast. On the other hand, the company may target to acquire an existing telecom company having sufficient customer base in South and to integrate its North India operation with the acquired company. It will yield quick results.

The company is willing to appoint the firm to identify and to take the process of acquisition forward. After study the M&A vertical of the firm has identified a company M/s Pool Limited which has got presence in South but is not doing too well. The information of both the companies is given below :

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

The P/E ratio of the combined entity is expected to be 10 ?

**CASE SCENARIO – 2**

Ms. Devina is fond of making cakes, pickles, papad and other eatables homemade and her friends persuaded her to take it as a venture. Before starting it as a venture, she wants to try it whether she should turn her hobby into a regular business or not. She lives in New Delhi. To start with, she promoted her products through her social media friends and started getting orders from nearby places like Noida (Uttar Pradesh), Faridabad (Haryana), Gurugram (Haryana). All these places fall within National Capital Region (NCR). She expects to have monthly turnover of ₹ 10,000.

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**CASE SCENARIO – 3**

M/s GAAR Limited enters into a 3 years lease of an immovable property with M/s GAP Limited for annual lease rental of ₹ 60,000 per annum. There is extension clause in the agreement which provides that lease may be extended to 5 years and in the present circumstances, it is most likely that the lease term will be extended. In case of extended period, the lease rent will be increased by 10%. Lessee's incremental rate of borrowing is 9%. M/s GAAR Limited has given residual guarantee to M/s GAP Limited of ₹ 50,000. If the lessee terminates the contract at any time before 3 years, the lessee will be required to pay ₹ 30000 as penalty to the lessor. PV Ratio of 5 years at 9% are as 0.917,0.842,0.772,0.708,0.650 respectively.

**CASE SCENARIO – 4**

Mr. B one of the partners of the firm is facing a dilemma as to whether the firm BMY LLP should accept the appointment as Statutory Auditors of M/s Foam Limited wherein Mr. B had sent a communication in writing addressed to the outgoing auditor Mr. Dalai under certificate of posting and the outgoing auditor has sent an acknowledgement vide their official email, but this email address of the outgoing auditor is not registered with the Institute of Chartered Accountants of India. Mr. B is of the opinion that this is not a positive evidence of delivery and violates the code of ethics, if the firm accepts the audit assignment.

**CASE SCENARIO – 5**

An investor has got investment in 3 stocks and is willing to know the beta of his portfolio. The following information in respect of these 3 stocks is given below :

Security	No. of Shares	Market Price	$\beta$
SVL	15000	60	0.90
SCL	8000	35	1.00
MLS	7500	30	1.50

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Provide the correct option to the following Questions

2 × 5 = 10

**Multiple Choice Questions**

3.1. The exchange ratio acceptable to M/s Pool Limited in case scenario-1 will be :

- (a) 0.42:1 (b) 0.50:1  
(c) 0.35:1 (d) 0.65:1

3.2. Will Ms. Devina in case scenario-2 be required to take registration under GST Act 2017 and whether she will be entitled to avail the composition levy scheme under the said Act :

- (a) She will not be required to take registration as her turnover is less than the basic limit fixed for registration.  
(b) She will be required to take registration as Composition supplier and will be eligible to take benefit of composition levy scheme.  
(c) As her sales are inter-state, she will be required to take registration but can take benefit of composition levy scheme.  
(d) She will be required to take registration and will not be entitled to take benefit of composition levy scheme as her sales are inter-state and when there is inter-state sale, there is neither basic exemption nor composition levy can be availed except for notified supplies.

3.3. What shall be the amount of lease liability and the finance cost for first year of M/s GAAR Limited under case scenario-3 :

- (a) Lease Liability ₹ 2,41,488 and Finance Cost ₹ 21,733  
(b) Lease Liability ₹ 3,62,000 and Finance Cost ₹ 32,580  
(c) Lease Liability ₹ 2,73,988 and Finance Cost ₹ 24,659  
(d) Lease Liability ₹ 3,03,988 and Finance Cost ₹ 27,359

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3.4. With respect to the dilemma being faced by Mr. B partner of the firm in case scenario-4 regarding acknowledgment of the communication from the retiring auditor's vide their official email is not a positive evidence of delivery ?

- (a) The dilemma of Mr. B is correct as it is not a positive evidence of delivery.
- (b) The dilemma of Mr. B is not correct as it is a positive evidence of delivery as the same is received from the official email of the outgoing auditor, as per the code of ethics.
- (c) The dilemma of Mr. B is not correct as statutory auditors are not required to communicate with the retiring or outgoing auditors in this case.
- (d) The dilemma of Mr. B is correct as the email address of the outgoing auditor vide which acknowledgement has come is not registered with the Institute of Chartered Accountants of India.

3.5. What would be the portfolio beta in case scenario-5 above ?

- (a) 1.133
- (b) 1.016
- (c) 1.074
- (d) 1.213

### Descriptive Questions

3.6. Explain about the professional misconduct as defined in Part I of the First Schedule to the Chartered Accountants Act regarding accepting a position as an auditor previously held by another chartered accountant without first communicating with him in writing. 4

3.7. Define 'Lease' as per Ind AS and explain its various components. 4

3.8. Explain the circumstances when a supplier is required to seek registration under the Goods and Services Tax Act 2017 and can avail the benefit of Composition Scheme. 7

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**CASE STUDY-4****Facts of the Case :**

1. A public limited company (hereinafter referred to as 'the company'), which is a wholly owned subsidiary of a listed company, is in the business of exploration and production of oil and gas and other hydrocarbon related activities outside India.
2. The company operates overseas projects directly and/or through subsidiaries, by participation in various joint arrangements and investment in associates. The company was following Accounting Standards as notified under the Companies (Accounting Standards) Rules, 2006 (ASs) until 31<sup>st</sup> March, 2016. However, in accordance with the Notification of Ministry of Corporate Affairs, the company has adopted Indian Accounting Standards (Ind ASs) with effect from 1<sup>st</sup> April, 2016.
3. Mineral rights are granted by the host governments in accordance with the applicable legal and fiscal regime in the host country which are incorporated into the binding contractual arrangements entered into with the host governments. Mineral rights can be granted through direct license or through Production Sharing Agreement (PSA), under which the host government having ownership rights over the hydrocarbons, grants the rights to a company or consortium (usually called contractor) subject to certain obligations/ payments by the contractor including sharing of hydrocarbons, with the government or its nominated agency as per principles contained in PSA.
4. The overseas oil and gas operations are generally conducted in joint arrangements with other partners. Main reason for holding mineral rights through jointly controlled entities/subsidiaries is because of host country's regulations and / or various business considerations (strategic/risk management/financing etc.). When the project is already in existence through a corporate structure and the company joins the project later on, the investment in jointly controlled entities/subsidiaries is a legacy issue.

5. Till the financial year 2014-15, the company has been preparing its consolidated financial statements for the group comprising of standalone financial statements of the company, its subsidiaries and jointly controlled entities in accordance with the applicable Accounting Standards (AS).
6. The company accounted for the investments in subsidiaries and jointly controlled entities in its standalone financial statements in accordance with the requirement of Accounting Standard (AS) 13, 'Accounting for Investments'. In consolidated financial statements of the company, the company was consolidating financial statements of its subsidiaries on a line by line basis following the consolidation procedures mentioned in paragraph 13 of Accounting Standard (AS) 21, 'Consolidated Financial Statements'. Similarly, in its consolidated financial statements, the company was reporting its interest in jointly controlled entities using proportionate consolidation as per the requirements of paragraphs 29 to 39 of Accounting Standard (AS) 27, 'Financial Reporting of Interests in Joint Ventures'.
7. Further, the company recognised goodwill in respect of subsidiaries and jointly controlled entities in accordance with the requirements of paragraph 13(b) of AS 21 and paragraph 36 of AS 27 respectively in its consolidated financial statements.
8. The company considered that such goodwill mainly arises due to corporate structure and the line by line consolidation of subsidiaries' / proportionate consolidation of jointly controlled entities' financial statements prepared on historical costs convention which do not take into consideration the valuation of underlying oil and gas reserves for which excess amount (i.e. goodwill calculated as per the relevant AS requirements) has been paid by the company at the time of acquisition.
9. The company further considered that in oil and gas E&P companies, the goodwill generated on acquisition of mineral rights either through jointly controlled entities or subsidiaries, inherently derives its value from the underlying mineral rights and, accordingly, value of such goodwill depletes as the underlying mineral resources are extracted.

10. Therefore, taking a prudent approach and considering the above substance, the company framed the accounting policy for amortisation of the goodwill in respect of its subsidiaries/jointly controlled assets over the life of the underlying mineral rights using UOP method as under : “Goodwill Amortisation: The company amortises goodwill (on consolidation) based on ‘Unit of Production Method’ considering the related Proved Reserves.”
11. This allowed the company to utilise the value of goodwill over the life of mineral rights and completely charging off the goodwill over the life of the reserves.
12. For financial year 2015-16, the company has stated that it had availed transition exemption under Ind AS 101, ‘First-time Adoption of Indian Accounting Standards’ and has not applied the principles of Ind AS 103, ‘Business Combinations’ retrospectively and, therefore, did not fair value the acquisition of shares in joint ventures (jointly controlled entities as per ASs) / subsidiaries which happened before the transition date of 1st April, 2015. Carrying amount of goodwill at the date of transition to Ind AS in accordance with applicable ASs has been taken as carrying value of the goodwill in the opening Ind AS Balance sheet.
13. According to the company, prospectively from the transition date, i.e., 1<sup>st</sup> April, 2015, acquisition of interest/ share in subsidiary is to be accounted for in accordance with Ind AS 103 and acquisition of interest/share in joint venture/associate will be accounted for in accordance with Ind AS 28, ‘Investments in Associates and Joint Ventures’.
14. The company understands that paragraph 32(a) of Ind AS 28 specifically prohibits amortisation of goodwill relating to an associate or a joint venture. It is noticed that there is no such specific prohibition laid down by Ind AS 103. It is also noticed that paragraph 10 (b) of Ind AS 36, Impairment of Assets requires testing of goodwill acquired in a business combination for impairment, annually.
15. Accordingly, as per the company, by simple reading of the applicable Ind ASs, it appears that Ind ASs envisage testing of goodwill annually for

impairment rather than its amortisation. This seems to align with the concept of fair valuation of acquired assets and liabilities and goodwill/capital reserve being a residual amount. This however may not be the case where goodwill is carried at historical value in the manner as stated above. Accordingly, considering the substance over form of the goodwill to be in the nature of 'acquisition costs' (as discussed in paragraphs 8 to 13 above), the company intends to continue amortisation of the goodwill recognised under ASs in respect of its subsidiaries/ joint ventures (jointly controlled entities under ASs) over the life of the underlying mineral rights using Unit of Production method, under Ind ASs also post transition date in accordance with the same accounting policy as under: "Goodwill amortisation : The company amortises goodwill (on consolidation) based on 'Unit of Production Method' considering the related proved reserves."

**Provide the correct option to the following Questions**

**Multiple Choice Questions**

**2 × 5 = 10**

- 4.1 As per Ind AS 110 which of the following parent entities are not exempted to present consolidated financial statement :-
- (a) If debt or equity instruments are not traded in a public market; it did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; and its ultimate or any intermediate parent produces financial statements that are available for public use and comply with Ind AS. Further its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements.
  - (b) An investment entity that is required to measure all of its subsidiaries at fair value through profit & loss account.
  - (c) Subsidiaries to which post-employment benefit plans or other long-term employee benefit plans applies.
  - (d) The parent that controls one or more other associate companies.



- 4.2 On consolidated financial statements the Auditor issues :-
- (a) Independent Auditors Report on Consolidated Financial Statement.
  - (b) Companies (Auditor's Report) Order, 2020 on Consolidated Statement.
  - (c) Independent Auditors Report on Consolidated Financial Statement as well as Companies (Auditor's Report) Order, 2020 on Consolidated Statement.
  - (d) Neither Independent Auditors Report on Consolidated Financial Statement nor Companies (Auditor's Report) Order, 2020 on Consolidated Statement.
- 4.3 In the consolidated financial statements the financial statement of parent and group prepared as one entity with respect to
- (a) assets, liabilities and equity only.
  - (b) income and expenses only.
  - (c) income, expenses and cash flows only.
  - (d) assets, liabilities, equity, income, expenses and cash flows.
- 4.4 The due date of filing the FLA (Foreign Liabilities & Assets) annual return under FEMA, 1999 is :-
- (a) by 30<sup>th</sup> May of the close of the financial year.
  - (b) by 15<sup>th</sup> June of the close of the financial year.
  - (c) by 30<sup>th</sup> June of the close of the financial year.
  - (d) by 15<sup>th</sup> July of the close of the financial year.
- 4.5 The general permission is not available to persons (individual) resident in India for purchase/acquisition of securities abroad when such purchase/acquisition is :
- (a) out of the funds held in the RFC account.
  - (b) by way of bonus shares on existing foreign currency shares.
  - (c) by remitting up to the limit prescribed by the Reserve Bank from time to time, per financial year under the Liberalised Remittance Scheme (LRS).
  - (d) by remitting under LRS to set up special purpose vehicle for further investment.

**Descriptive Questions**

- 4.6 You have been asked to explain regarding appropriate accounting treatment under Ind AS for amortisation of the goodwill by the company and that whether the accounting treatment as suggested in paragraph 15 of the case study in respect of amortisation of goodwill by the company is appropriate ? 7
- 4.7 What are the formalities under the Foreign Exchange Management Act, 1999 for setting up a jointly controlled entity abroad ? 5
- 4.8 What is the process of acquiring of shares of an existing company abroad under the Foreign Exchange Management Act, 1999 ? 3

**CASE STUDY-5****Facts of the Case :**

1. HV Company Limited (hereinafter referred as HVCL) manufactures heavy equipment for construction industry.
2. An order for supply of 90 Nos. of equipment (T-model dumpers) was received from AB Infra Limited (herein after referred as ABIL). The unit price of the equipment was agreed at ₹ 190 lakhs each. 64 Nos. of equipment were supplied during the year 2017-18 and balance quantity remaining to be supplied as on 31.03.2018. HVCL has 51 Nos. of the equipment in its inventory as on 31.03.2018. HVCL considered that the contract was an onerous contract and therefore, the net realisable value of inventory has been taken as value of inventory as on 31.3.2018. One of the terms of the supply order was that the supplier would be responsible for warranty towards technical defects in the equipment supplied during the two years' period from the date of supply.
3. From the details of cost of production and cost of sales, it was pointed out by the auditors of the HVCL that the cost of fulfilling the contract exceeds the economic benefits expected to be received from it. Hence, the contract is onerous and provision towards the same needs to be made.

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4. The management of HVCL replied to the auditors that Ind AS 37 defines an onerous contract as a contract in which the unavoidable costs of meeting the obligation under the contract exceeds the economic benefits expected to be received under the contract. The unavoidable costs under a contract reflect the least net cost of exiting from the contract by way of compensation or penalties. As per the terms of the contract, if contractor failed to supply, the customer can purchase the equipment at the risk and cost of the defaulting supplier with forfeiture of security deposit as applicable. As the subject contract is on-going contract, such exiting cost cannot be measured. Unavoidable cost does not include allocated share of cost that will be incurred regardless of whether the entity fulfils the contract or not. Moreover, other expenditure like administrative overheads, R&D, finance charges, head quarter expenditure, sales overheads etc., are of the nature of period cost and the purpose of these expenditure related to the said sales order is already completed in 2017-18 itself with receipt of sale order. Hence, there is no non-compliance of Ind AS 37.
5. Indian Accounting Standard (Ind AS) 37, 'Provisions, Contingent Liabilities and Contingent Assets' defines an onerous contract as, "a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it". Further, as per Ind AS 37, "the unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfil it." The company believed that unavoidable costs of meeting the obligations under the contract are only costs that: "are directly variable with the contract and therefore incremental to the performance of the contract;" do not include allocated or shared costs that will be incurred regardless of whether the entity fulfils the contract or not; and cannot be avoided by the entity's future actions.

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6. The management of HVCL has further submitted to the auditor the details of costs that have been considered for creation of provision towards onerous contract :
- (a) Material cost - includes cost of material procured, cost of freight & insurance incurred for material procurement and handling, loading and unloading charges incurred.
  - (b) Labour cost/ Factory Overheads - includes salaries and other expenses of direct production department; and also expenses allocated from indirect departments to direct department.
  - (c) Material Overheads - Includes salaries and other expenses (including expenses allocated from other departments) booked under departments linked with materials like purchases, stores and quality control.
7. The provision has been made considering the above costs only. For example, the value of provision created for a quantity of 21 Nos. remaining to be produced is as per working shown below :

Particulars	Value (₹ in lakhs)
(i) Cost of production (which includes material cost, labour cost/factory overhead and material overhead)	199.00
(ii) Selling price	190.00
(iii) Differential cost of 9 Lakh per equipment( No. of equipment remaining to be produced 21)	189.00
(iv) Costs incurred towards administrative overheads, finance charges, R & D expenses, sales overhead, head quarter expenditure etc., are considered as period cost and hence not considered for creation of provision.	

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8. HVCL has prepared its computation of taxable income for A.Y. 2018-19 declaring an income of ₹ Nil under the normal provisions and Book Profits under section 115JB of the Income Tax Act of ₹ 8.56 Crores. The loss to be returned by the company under normal provisions of the income tax in the return was ₹ 5.23 Crores.

**Provide the correct option to the following Questions**

**Multiple Choice Questions**

**2 × 5 = 10**

- 5.1 Under the provision of 115JB, the basic rate of income tax applicable on the Book Profit is :

- (a) 15% (b) 18.5%  
(c) 22.5% (d) 25%

- 5.2 The company covered under the provisions of Section 115JB requires to upload a report from the Chartered Accountant in :

- (a) Form -3CA (b) Form -3CEB  
(c) Form-15CB (d) Form-29B

- 5.3 As per Ind AS 37, a legal obligation is derived :-

- (a) from legislation.  
(b) from a contract (through its explicit or implicit terms).  
(c) from any operation of law.  
(d) from legislation or from a contract or from any other operation of law.

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5.4 In calculating the Book Profit, deduction is allowed with respect to :-

- (a) brought forward business loss.
- (b) unabsorbed depreciation.
- (c) brought forward business loss or unabsorbed depreciation whichever is lower.
- (d) brought forward business loss or unabsorbed depreciation whichever is higher.

5.5 As per Ind AS 37, an entity shall recognise :-

- (a) A provision when an entity has a present obligation (legal or constructive) as a result of a past event; it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.
- (b) A provision irrespective of any present obligation (legal or constructive) as a result of a past event; it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.
- (c) A contingent liability.
- (d) A contingent asset.

(23)

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**Descriptive Questions**

- 5.6 Whether the company's accounting treatment of cost for creation of provision towards onerous contracts is in line with the provisions of Ind AS 37? 6
- 5.7 Please explain how provision for onerous contract made in the books of account have to be dealt with in preparation of computation of taxable income by HVCL for A.Y. 2018-19? 5
- 5.8 Please also explain how HVCL shall consider the warranty clause in the supplies of equipment made to ABIL in preparation of computation of taxable income for AY 2018-19? 4

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