CASE STUDY 10

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

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

Sahana explains the following open issues to Madan:

Issue 1

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

	Particulars	₹ Lakhs
(1)	WDV of Plant & Machine (P & M)	30
(2)	New P & M purchased and put to use on 8th June 2023*	20
(3)	New P & M acquired and put to use on 15th December 2023*	8
(4)	Computer acquired and installed on 2nd January 2024	3

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

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

Issue 2

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

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

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

Issue 3

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

Issue 4

Company at the Annual General Meeting (AGM) held on 30th September 2021 appointed Gana as a Non-Executive Director on the board of the Company for a period of three years. On 2nd October 2021, Gana met with an accident and died on the spot. The Board of Directors of the Company on 16th October 2021 appointed Hero to fill the casual vacancy so created. Appointment of Hero was made for a term of three years by the Board unconditionally. The next General Meeting (GM) was held on 29th October 2021.

Issue 5

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

I. Multiple Choice Questions

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(a) i, ii, and iii

(b) i and ii

(c) i and iii

(d) ii and iii

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

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

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

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

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

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

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

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

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

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

II. Descriptive Questions

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

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

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

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

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

ANSWERS TO THE CASE STUDY 10

I. Answers to the Multiple Choice Questions

1 **(c) Maximum Depreciation as follows**

Particulars	**Plant & Machinery @ 15%**	**Computer @ 40% (₹)**
Normal Depreciation @15% on ₹ 50.00 Lacs (30+20)	7.5	
@7.5 on ₹ 8.00 Lacs – put to use for Less 180 days	0.6	
@ 20% on ₹ 3.00 Lacs – Put to use for less than 180 days		0.6
Additional Depreciation @ 20% on ₹ 20.00 Lacs (new machinery)	4.0	

Additional Depreciation @ 10% on Rs. 8.00 Lacs (new machinery) put to use for less than 180 days	0.8	
TOTAL	12.9	0.6

The answer is ₹ 13.5 lakhs

2 (d) Calculation of Impairment loss

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

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

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

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

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

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

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

5 **(b)** Section 194-IA read with section 195 requires every transferee responsible for paying any sum as consideration for transfer of immovable property (land, other than agricultural land, or building or part of building) to deduct tax, at the rate of 1% of higher of consideration and stamp duty value, at the time of credit of such sum to the account of the resident transferor or at the time of payment of such consideration to the resident transferor, whichever is earlier. However, no tax is required to be deducted where the consideration for transfer of an immovable property and stamp duty value of such property, both are less than ₹ 50 lakhs.

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

II. Answers to the Descriptive Questions

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

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

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

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

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

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

External sources of information

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

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

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

Internal sources of information

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

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

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

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

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

8. Different Roles of Executive and Non-Executive Directors

The Board of Directors may comprise both executive and nonexecutive directors. The executive directors are responsible for managing different business operations. A whole time director and the Managing Director are covered under this category. In contrast, the non- executive directors participate through Board Meetings in discussions relating to formulation of policies from the efficient management of the business. Professional directors and nominee directors are included in this category. They are not as active as that of executive directors and they are held liable only if they knowingly consented for wrongful acts.

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

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

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

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

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

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

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

(g) scrutiny of inter-corporate loans and investments

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

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

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