CASE STUDY 14

BASP & Co. Chartered Accountants is a firm of Chartered Accountants, having offices across major towns of south India. They provide consultancy in the field of GST, income-tax and corporate law consultancy. ABC Private Ltd is a one of the major clients of the firm having a dynamic and professional Finance team., Tan & Kan, the Partners of BASP & Co, had regular meetings with Jay, the Director (Finance) of ABC Private Ltd and his team. During one of the meetings, Jay seemed to have quite some points for discussion with Tan & Kan. Having seen new members in the audit team, Jay gave a quick overview about the Company and its operations for their understanding. He explained that the Company manufactures and supplies air conditioners (AC), refrigerators, and other products.

He went on to explain the following points:

(A) The Company is expanding its business and establishing a new unit with an estimated budget of ₹ 250 Lakhs. The break-up of this expenditure is as follows:

Civil construction	₹ 120 Lakhs (excluding GST)
Plant and Machinery	₹ 130 Lakhs (excluding GST)

The civil construction cost of ₹ 120 Lakhs above includes construction of foundation for installation of Plant and Machinery. The cost of construction of foundation is ₹ 20 Lakhs. CGST and SGST for both civil construction and Plant and Machinery is 9% each i.e.18% in aggregate. The details of expenditure are as under:

Date	***Details***	***Amount ₹ Lakhs***
1st April 2023	*Advance given for Plant & Machinery*	*40*
	Advance to contractor for civil construction	*10*
15th April 2023	*Work of construction begins*	
30th April 2023	*Civil construction work expenses*	*25*
31st July 2023	*Civil construction work expenses*	*25*
1st October 2023	*Payment made to suppliers of Plant and Machinery and delivery received*	*90*
31st December 2023	*Construction work expenses*	*20*
31st March 2024	*Final payment made (including outstanding GST)*	*40*

(B) During the financial year 2023-24, in one of the Board meetings, the management sought an approval from the Board, for investing in equity shares of other Companies as per the provisions of the Companies Act, 2013. The Board approved the management's proposal, after due deliberations and discussions. The Company purchased 10,000 shares of Milaan Ltd. on 1st January 2023 at a price of ₹ 20 per share. Milaan Ltd.

declared bonus of one share for every 2 shares held on 31st March 2023 as record date for issue of bonus. The Company sold 10,000 shares purchased on 1st January 2023 on 31st August 2023 at ₹ 15 per share.

(C) In addition to manufacture and supply of ACs, the Company also does installation for the same. It had received advance of ₹5 Lakhs for supply of5 split air-conditioners to Bavana Ltd. for installation at their factory in Haryana on 15thFebruary 2024. The Company supplied the ACs and installed them on 28thFebruary 2024 and issued the invoice on the same date i.e. 28th February 2024. The supply was chargeable to tax@ 18% but was reduced to 12% from 25th February 2024. The Company charged GST @ 18% while the buyer Bavana Ltd. contended that GST should have been charged @ 12% as the supply was made after the change of rate.

(D) The Company had entered into an agreement with Humlog Private Ltd, for supply man-power on contract basis. This agreement was in existence for more than 8 years now and both the parties renewed the agreement every two years. However, the Company noticed that the services provided were not up to the mark. Though the agreement was due for renewal this month, the Company raised a dispute relating to quality of man-power and was planning to invoke the arbitration clause.

(E) During the financial year 2019-20, the Company bought back equity shares worth ₹ 5 Crores resulting in 5% decrease in combined outstanding of paid up share capital and free reserves. Further to this, during the financial year 2021-22 bonus shares were issued in the ratio of 3:2. Bonus shares were issued using the amount lying in securities premium account. Both the actions of the Company were according to the guidelines prescribed under the Companies Act. Tan and Kan endorsed this fact and also added that appropriate disclosures were made in the financial statements.

(F) Jay was happy to inform that the Company's operations were going on smoothly and they were on a growth trajectory. During the financial year 2022-23, the Company had a turnover of ₹ 100 Crores and there was Loan outstanding from a bank of ₹ 75 Crores and deposits of ₹ 30 Crores.

(G) After the audit discussions were over, Jay and Kan had a general discussion. During the conversation he mentions that Shahi, a shareholder and non executive director of the Company has become the present Member of Parliament. His son, Abhir is studying abroad in US. As the present term of Parliament is coming to an end next year and his term also will come to an end. Shahi is willing to contest next election as an independent candidate. He has many friends and relatives in US and he asked his son to contact them, to collect fund for his election. Jay also told Ranga, Shahi's friend who is a contractor working for Ministry of Transport, Shipping and National Highways also accompanied Shahi on the US trip as part of government delegation.

(H) Jay asked Tan and Kan, if they could help his friend Merun, Partner Mahim& Co, Chartered Accountants. Jay and Merun were close friends and they often used to have professional and academic discussions. Tan and Kan gladly agreed to provide clarifications to Merun, if he had any technical query. Jay set up a zoom call between Merun and them. During the call, Merun said he would be more comfortable and confident, if some other Chartered Accountant reviews the financial statements and audit reports he is signing.

I. Multiple Choice Questions

1. Is ABC Private Ltd required to appoint an internal auditor during the financial year 2023-24 for complying with the provisions of Companies Act,2013?

   (a) The Company is required to appoint internal auditor as one of limits of appointment of internal auditor is met by the company.

   (b) The Company being a private company is not required to appoint internal auditors.

   (c) The Company is not required to appoint the internal auditors, as the appointment of internal auditor is a matter of Board's decision.

   (d) The Company is not required to appoint internal auditor because the thresholds prescribed under the Act, have not been met.

2. The Company will treat the loss on sale of shares as:

   (a) Loss of ₹ 50,000 on sale of 10,000 shares will be claimed as a loss.

   (b) There will be gain of ₹ 16,666.67 as the cost of shares will be spread across total 15,000 shares.

   (c) The Company cannot claim the loss of ₹ 50,000. However, this loss of ₹ 50,000 will become cost of acquisition of remaining 5000 shares received as bonus.

   (d) Loss of ₹ 50,000 cannot be claimed as loss and the cost of acquisition of bonus shares will be 'nil'.

3. In the background of the facts given above, the amount which ABC Private Ltd. is entitled to take credit for Input tax (ITC) of ₹

   (a) ₹ 45 Lakhs

(b) ₹ 27 Lakhs

(c) ₹ 23.40 Lakhs

(d) ₹ 21.60 Lakhs

4. Advise ABC Private Ltd, what is the correct position of law in the facts given in case study:

(a) Since payment was received prior to change of rate of tax, old rate will be applicable.

(b) Since provision of supply and issue of invoice is after the change in rate of tax, and only payment has been received before the change in rate, new rate shall be applicable.

(c) Since the time of supply shall be earlier of date of receipt of payment and date of issue of invoice, old rate shall be applicable.

(d) Since provision of service is after the change in rate of tax, new rate shall be applicable. Date of invoice is not relevant.

5. Whether the transactions of buy back and bonus shares are required to be reported in the financial statements for the financial year 2023-2024?

(a) As per schedule III to the Companies Act, 2013, the comparative information for last financial year needs to be presented and the said transactions do not pertain to last financial year, hence no reporting is required.

(b) As per schedule III to the Companies Act, 2013, only transaction of buy back completed in last three financial years is required to be reported.

(c) As per schedule III to the Companies Act, 2013, only transaction of bonus shares issued during last three financial years is required to be reported.

(d) As per schedule III to the Companies Act, 2013 both bonus shares issued and shares bought back during last five financial years needs to be reported.

II. Descriptive Questions

6. Explain the circumstances under which an arbitration agreement can be terminated. Will the Company be successful in invoking the arbitration clause against Humlog Private Ltd.

7. Jay feels it is not appropriate for Shahi to seek funds for election in such a manner. With reference to the Foreign Contribution (Regulation) Act, 2010, explain who are prohibited from taking any contributions from a foreign source.

8. In background of Merun's discussion with Tan and Kan, answer the following:

   (i) Can the financial statements and audit report signed by Merun be reviewed by some other Chartered Accountant? If yes, who can do such review in terms of Standard on Quality Controls Auditing, Review, Other Assurance and Related Services.

   (ii) What should be the contents of the review policy and procedures, if Merun's firm is required to establish such policy?

ANSWERS TO THE CASE STUDY 14

I. Answers to the Multiple Choice Questions

1. **(d)** Rule 13 of the Companies (Accounts) Rules 2014

The condition of deposit does not apply to a Private Company.

2. **(c)** According to section 94(8), where (a) any person buys or acquires any securities or units within a period of three months prior to the record date; (b) such person is allotted additional securities or units without any payment on the basis of holding such securities or units on such date; (c) such person sells or transfers all or any of the securities or units referred to in (a) above within a period of nine months after such date, while continuing to hold all or any of the additional securities or units referred to in (b), then –

   (i) the loss on sale of original securities or units sold within a period of 9 months after the record date will be ignored for the purpose of computing his income chargeable to tax and

   (ii) the amount of such loss so ignored will be deemed to be the cost of purchase or acquisition of the bonus securities or units referred to in (b) above, held by him on the date of such sale or transfer

The Company cannot claim the loss of` 50,000. However, this loss of ` 50,000 will become cost of acquisition of remaining 5000 shares received as bonus.

3. **(b)** On Foundation work = ₹ 20 Lakhs + Plant and Machinery ₹ 130 Lakhs = 150 Lakhs @ 18% = 27 Lakhs

4. **(b)** Section 14(b)(iii) of the CGST Act

5. **(d)** As per schedule III to the Companies Act, 2013 both bonus shares issued and shares bought back during last five financial years needs to be reported.

II. Answers to the Descriptive Questions

6. Following are the Circumstances in which an Arbitration agreement can be terminated:

Like the manner in which parties enter into an arbitration agreement, they can also terminate an arbitration agreement.

Thus, an arbitration agreement could be put to an end by:

1. **Mutual Consent:** Like any contract, the parties involved can jointly agree to put an end to a particular arbitration agreement.

2. **Termination of Principal Contract:** If the principal contract is terminated through discharge or novation, the arbitration agreement terminates with the contract. However, if the principal contract is breached, then the arbitration agreement survives because of the operation of the doctrine of separability.

3. **Death of Parties:** Under the Indian Law, an arbitration agreement is not discharged by the death of any party.

   It shall be enforceable by or against the legal representatives of the deceased.

4. **Operation of Law:** An arbitration agreement can be extinguished by the operation of law by virtue of which any right of action is extinguished.

Yes, company will be successful in invoking the arbitration clause against Humlog Private Ltd. on the basis of the termination of principal contract meant for supply of man-power on contract basis.

7. As per **Section 3 of the Foreign Contribution (Regulation) Act** (FCRA),2010, certain prohibitions are imposed on acceptance of foreign contribution.

Following are the categories of persons on whom directly/indirectly prohibitions are imposed on acceptance of foreign contribution:

(1) No foreign contribution shall be accepted by any:

(a) candidate for election;

(b) correspondent, columnist, cartoonist, editor, owner, printer or publisher of a registered newspaper;

(c) public servant, Judge, Government servant or employee of any corporation or any other body controlled or owned by the Government;

(d) member of any Legislature;

(e) political party or office-bearer thereof;

(f) organization of a political nature as may be specified under Section 5(1) by the Central Government;

(g) association or company engaged in the production or broadcast of audio news or audio visual news or current affairs programmes through any mode of mass communication

(h) correspondent or columnist, cartoonist, editor, owner of the association or Company referred to in clause (g).

(2) The Act also prohibits acceptance of foreign contribution by the following persons:

(a) Person, resident in India, and citizen of India resident outside India- shall not accept any foreign contribution, or acquire or agree to acquire any currency from a foreign source, on behalf of any political party, or any person referred to in (1) above, or both.

(b) Person, resident in India- shall not deliver any currency, whether Indian or foreign, which has been accepted from any foreign source, to any person if he knows or has reasonable cause to believe that such other person intends, or is likely, to deliver such currency to any political party or any person referred to in (1) above, or both.

(c) Citizen of India resident outside India- shall not deliver any currency, whether Indian or foreign, which has been accepted from any foreign source, to—

(i) any political party or any person referred to in (1) above, or both; or

(ii) any other person, if he knows or has reasonable cause to believe that such other person intends, or is likely, to deliver such currency to a political party or to any person referred to (1) above, or both.

In the give case study, Shahi, who is Member of Parliament and willing to contest next election as an independent candidate. He is seeking funds for his election. He asked his son, Abhir to contact his friends and relatives in US to collect funds.

According to Section 3(1)(a) of the Foreign Contribution (Regulation) Act, 2010 provides that no foreign contribution shall be accepted by any candidate for election.

Therefore, Jay was correct that it is not appropriate for Shahi to seek funds for election in such stated manner.

8. (i) As per **SQC 1**, some sole practitioners or small firms may wish to use other firms to facilitate engagement quality control reviews. Accordingly, financial statements and audit report signed by Merun can be reviewed by some other Chartered Accountant.

The firm's policies and procedures should address the appointment of engagement quality control reviewers and establish their eligibility through:

(a) The technical qualifications required to perform the role, including the necessary experience and authority; and

(b) The degree to which an engagement quality control reviewer can be consulted on the engagement without compromising the reviewer's objectivity.

(ii) Engagement Quality Control Review:

The firm should establish policies and procedures requiring, for appropriate engagements, an engagement quality control review that provides an objective evaluation of the significant judgments made by the engagement team and the conclusions reached in formulating the report. Such policies and procedures should:

(a) Require an engagement quality control review for all audits of financial statements of listed entities;

(b) Set out criteria against which all other audits and reviews of historical financial information, and other assurance and related services engagements should be evaluated to determine whether an engagement quality control review should be performed; and

(c) Require an engagement quality control review for all engagements meeting the criteria established in compliance with subparagraph (b).

The firm's policies and procedures should require the completion of the engagement quality control review before the report is issued.

The firm should establish policies and procedures setting out:

(a) The nature, timing and extent of an engagement quality control review;

(b) Criteria for the eligibility of engagement quality control reviewers; and

(c) Documentation requirements for an engagement quality control review.