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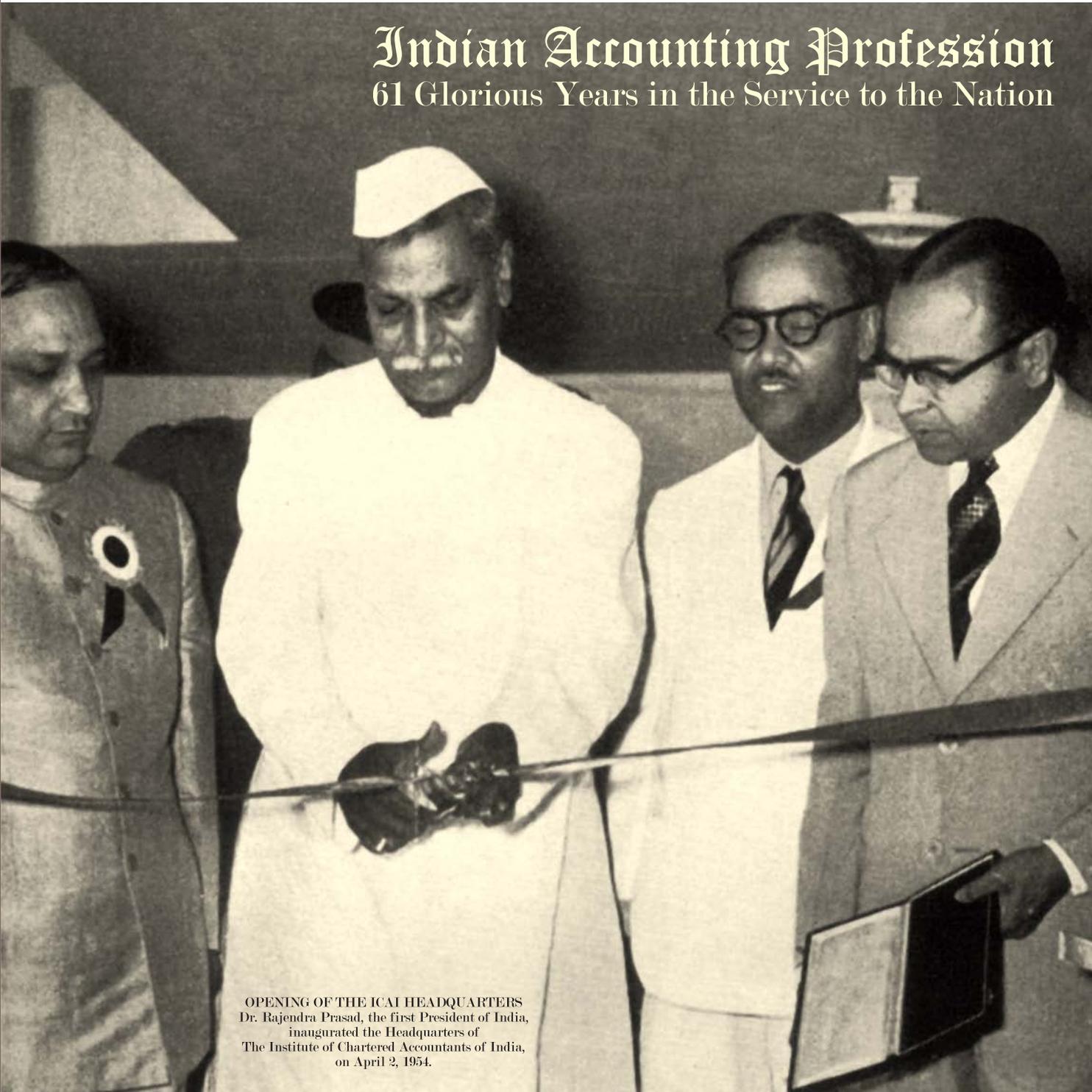
# Chartered Accountant Student

Your Monthly Guide to the CA News, Information & Events

STUDENT'S JOURNAL

July 2010 Vol SJ1 Issue 7 Pages 36

## Indian Accounting Profession 61 Glorious Years in the Service to the Nation



OPENING OF THE ICAI HEADQUARTERS  
Dr. Rajendra Prasad, the first President of India,  
inaugurated the Headquarters of  
The Institute of Chartered Accountants of India,  
on April 2, 1954.



## President's Communication

Dear Students,

I extend my warmest greetings and felicitations on the propitious occasion of Chartered Accountants' Day (1st July). It is a very momentous day to recapitulate the splendid past and strengthen our solidarity. Since the day of inception, our Institute has been contributing significantly to the significant growth of Indian Economy and building a congenial ambience for professional escalation. We at the Institute are determined to undertake responsibility to work hard to ensure transparency and accountability at the multi-disciplinary levels of society.

I would like to advise you to keep abreast of the recent trends and developments that are happening in the sphere of knowledge and learning. The technological revolution has brought radical changes in the process of sharing the information and disseminating knowledge. Since our CA course is based on the concept of distance learning hence, Information Technology may prove an effective delivery medium to impart knowledge at your convenience. Our Institute is geared up to launch its exclusively designed centralized live virtual classes in Information Technology Training Course.

We hope that this novel initiative of the ICAI will redefine the learning process.

I am pleased to note that the present issue of the Chartered Accountant Student Journal is having its focus on International Financial Reporting Standards (IFRS). I strongly recommend you to remain aware about the latest Accounting Standards. Our Institute is already running a Certificate Course on International Financial Reporting Standards (IFRS). It is expected that by the year 2011, more than 150 countries including India, would adopt/converge with IFRS.

In the changing scenario, Chartered Accountants have to play pivotal role in ensuring the integrated professional services to their respective clients in order to increase India's share in global economy. With a stupendous growth in the economy, the profession of Accountancy is all set to unwind plethora of opportunities. I am pretty confident that you will strive hard to excel in this gratifying and challenging profession.

Wishing you best for all your future endeavours.

Yours sincerely,

**CA. Amarjit Chopra**

President, ICAI, New Delhi



## Vice-president's Communication

Dear Students,

At the outset, I convey my heartiest greetings to you on the happy occasion of Chartered Accountants' Day (1st July). Indeed, it is a matter of great pleasure for our fraternity to celebrate this auspicious day with full spryness and reverence. Our Accounting Profession is growing by leaps and bounds. The success of our profession largely looms upon your scrupulous efforts. We have high hopes from the generation next of CA professionals as we consider them our torchbearers to uphold the noble spirits, values and ethics of our coveted profession.

The profession of Chartered Accountancy is regarded as one of the most eminent and reputed professions. The profession of Accountancy is synonyms of integrity, reliability and honesty. The prestigious Chartered Accountancy Course offers you a life time opportunity to translate your dreams

into reality. Along with multifaceted knowledge, you can mould your career in enriching your knowledge bank in the specialized area of Accounting, Auditing, Corporate Finance, Corporate Laws, Corporate Governance, Information System, Taxation etc.

I would like to exhort our students to keep a balance with theoretical knowledge and practical training. Theoretical knowledge is very imperative to clarify the basic concepts and develop a high level of understanding. Similarly, a sincere and committed approach towards the Articleship training is must for a burgeoning Accounting Professional as it instills necessary skills in applying theoretical knowledge to practical situation. You should remember that "*practice without theory has no route and theory without practice has no fruit.*"

*With best wishes and good luck!*

Yours sincerely,

**CA. G. Ramaswamy**

Vice-President, ICAI, New Delhi



## Message From The Chairman, Board of Studies

### How to conduct as a CA Student Dear Students,

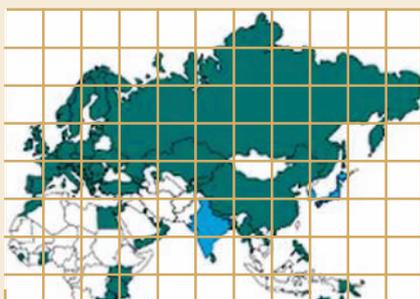
I am deeply honored to address you all, especially on the occasion of the CA Day. As you are all aware that you are representing a noble profession, i.e. Chartered Accountancy, with onerous duties towards your clients, the society, the nation as also towards yourselves and the firms, where you are undergoing article ship. Although, you must be following certain basic rules on how to conduct yourselves, I would like to highlight some important tips, which would be beneficial to you all.

- **Outward Appearance:** You should wear neat formal dress and have proper appearance while ensuring odorless body – may apply a simple deodorant. Proper shave, simple make up and properly polished shoes are all parts of formal attire. No T Shirts, Jeans, Chappals or informal Sandals.
- **Relationships:** The relationships with the principals, clients and colleagues including seniors and juniors need to be very carefully nurtured and maintained as these will be important throughout your life. It is important to give respect to seniority, age and experience. Using appropriate suffix, for example ‘Sir’ or ‘Ji’ will add great value to your communication.
- **Behavior:** Be humble and polite but firm towards your professional values and culture. It is important to follow excellence, independence and integrity as basic principles.
- **Truthfulness:** It is important to ensure to be true to yourself. Your creditability among your peers, principals, society and clientele will develop only on truth and truth alone. Don’t give excuses or false replies.
- **Quest to Learn:** Accept mistakes and get the doubts clarified. Try to learn maximum. Please leave your hesitation and fear. The period of training and student-age has to be utilized very effectively. Undertake all jobs assigned to you meticulously and sincerely. No work is less important than the other. Be always eager to do the maximum jobs of whatever nature for learning is imbibed even in the menial jobs. If you undertake small jobs effectively, you will be considered fit for better and bigger jobs. Remember the longest journey always starts with a small step.
- **Professions’ Ambassador:** It is important to appreciate that while dealing with your clients you are representing CA profession, your own family and more importantly your professional firm whose reputation among the clientele and the society will be determined by your work, talk and behavior.
- **Knowledge Showcase:** Please prepare yourself fully while you go to the clients after reading all relevant papers, all files, documents, and acquired knowledge of business and law, which govern your clients.
- **Team Work:** Working in team along with seniors, juniors and your peers in an effective and efficient manner while giving respect to all and contributing effectively as a team member is very important. Any attempt to get entire credit for your contribution to yourself will be futile.
- **Discipline:** Adhering to time as per the rules of the organization is very important, besides ensuring that during office hours your personal mobile is switched off. Also strictly avoid personal emailing and gossiping. In case you want leave for very urgent and emergent work, please take approval in advance and don’t make any program with your family or otherwise without advance confirmation from your office. Don’t make excuses and take unnecessary leave as your maximum attendance will ensure better learning and your success in examination.
- **Attitude:** Your association and relation with your CA firm is of a student and a guru. You are not obliging your principals while completing various assignments, it is only your great luck that you have got an opportunity to understand very confidential business process, documents and details of client’s business. So always maintain the right attitude. Be Positive!
- **Confidentiality:** Affairs of your firm and affairs of your clients are very confidential and confidentiality is the key to success. No loose talks about the client and about your firm should be undertaken with anybody how so ever close one may be. The CA student should be very particular about talk and behavior in the society including while you are dealing with the clients and dealing with your principals and peers. ICAI has issued a Code of Conduct for students which may be carefully read and adhered to ensure long term success.
- **Training Importance:** It is important to take up your training very seriously as the examination questions and your passing is fully dependent on your practical knowledge and skill.

I wish you great success and strength as a leading professional in your career. You can write to me at [vinodjain@icai.org](mailto:vinodjain@icai.org) for any problem or suggestions.  
With regards,

Yours sincerely,

CA. Vinod Jain  
Email : [chairmanbos@icai.org](mailto:chairmanbos@icai.org)



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**Board of Studies**

The Institute of Chartered Accountants of India,

ICAI Bhawan, A-94/4, Sector-58,

Noida-201 301.

**Phone : 0120-3045938**

Correspondents with regard to subscription,  
advertising and writing articles

**Email : writesj@icai.org**

Non-receipt of Students' Journal

**Email : nosj@icai.org**

**Head Office**

The Institute of Chartered Accountants of

India, ICAI Bhawan, Indraprastha Marg,

New Delhi - 110 104.

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**Editor: CA. Vinod Jain**

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# Origin of Accountancy

It is impossible to separate accountancy as a discipline from social, economic and historical contexts and conceptualize it as a set of neutral and technical tools.

## I Ancient India

India through its 9000 years of civilizations has contributed to the evolution of accounting system in many ways.

### Tokens: Beginning of Accounting

Small geometric clay objects (cylinders, cones, spheres, etc.) or tokens were found all over the near East from about 8000 B.C. A collection of tokens could represent a promised transaction. It required secure methods of keeping groups of tokens. The total sum of tokens inside the envelope or on a string represented the equity that a creditor lent to a debtor, which was similar to a super count or a *balance sheet*. Later tokens were impressed on a solid lump or tablet of clay and the tablets were then kept as records. This system was superseded around 3500-3200 BC by the counting tablets of the *sexagesimal*, i.e. relating to sixtieths, giving birth to the actual recording in writing and counting system, and the beginning of pictographic writing around 3300-3200 BC. Accounting was the greatest and, probably, the only inspiration leading to the birth of writing.

### Chitragupta: Accountant from Mythology

According to Hindu mythology, Chitragupta is believed to keep meticulous, complete and accurate records of the actions of all life forms from birth to death.

## First Coins

*Nicka* is the earliest reference about coins, as referred to in Zgveda (circa 1500 BC). Coins were introduced and used in trade in India, China and Asia-Minor in 6th century BC. First coins were issued by the Greek living in Lydia (modern western Turkey).

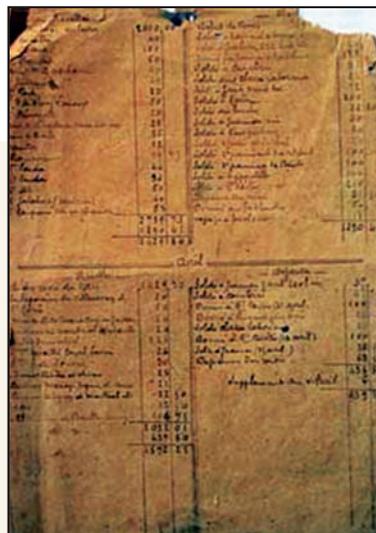
## Earliest References

Taxation was theoretically justified as a return for the protection granted by the king. Before the dawn of Mauryan times, tax-collectors were appointed over groups of villages. The basic tax used to be that on land, usually called *bhâg* (share), paid usually in kind. Tax was also levied on shops and necessary industrial equipments like looms, potter's wheels and oil presses. Jâtakas refer to the collection of tax

by kings. Nâradasm[ti has references to lending of money at interest, sureties, pledges, documents, witnesses, oaths, and also detailed provision on partnership. Mahâbhârata by Veda Vyâsa also has references to accounts.

## From Kingdoms of the South

The kingdoms of the South like Râcmrakûmas, Cholas, Cheras, Pallavas and Panyâs had great maritime trade with the help of natural harbours. There existed *Temple Economy*, as temples coordinated and carried out all the functions of economy including grants of land and loans. All records of royal treasury were kept on copper plates and stones. Cholas had a large land revenue department for maintenance of accounts.



### From Arthauâstra and Other Treatises

In Arthauâstra, three chapters provide an encompassing account on accounting, and deal with some vital concepts in accounting including expenditure and profit, checks and balances, and audit practices. Arthauâstra identifies revenue centres for accounting and accounting heads. The testimony of Megasthenese corroborated by the Arthauâstra shows that prices were regulated by market officials during Mauryan times.

### From Manusmriti

Manusmriti, written during 200 BC to 200 AD, mentions taxes that were payable to the king. Traders were supposed to calculate their taxes after considering costs, sales, distance, i.e. freight, cost of protection and procurement, and sustenance charges in connection with the deals.

### Qur'ân and the Islamic tradition

Islâm prompted accounting practices with the imposition of *zakât* (poor-dues) as one of its five pillars in 624 AD. It promoted the practice of accounting for calculating and paying *zakât* as the purification of earnings. It is an obligatory payment by all Muslims. House and personal transportation were exempted from *zakât*. It is not mandatory on harvest if the total did not reach a minimum limit. In 976 AD, Al-Khawarizmy for the first time documented these systems and used *muhasabah* for the function of accounting. The person responsible for this function is *muhasib* (accountant). Another scholar Al-Mazenderany, in his book *Risâlah Falakujyah Kitâbus Siyâkat* published in 1363 AD, documented accounting practices of the Muslim society.

### Arthasâutra and Islâmic Accountancy

Both Arthauâstra and *Risâlah* refer to accounting period. Arthauâstra identifies a year, a month, a fortnight and a day as accounting periods facilitating intra-year comparisons. The beginning of the year is the first day of *SirâwaGa* month of the Hindu calendar. *Risâlah* calls this 12-month period as *al-hawl*, as *zakât* was payable only on assets held for more than a period of an *al-hawl*.

### Indian Mathematician Giants

Âryabhamma (476–550 AD), discovered the value of  $\pi$  and proved that it is irrational in his

*Âryabhamiya*. Such an important, landmark and innovative play of digits contribute to the refinement of the accounting practices.

## II Medieval India

### From Delhi Sultanate and Mughal Empire

Delhi Sultanate introduced administration based on Islam in sync with local beliefs and customs in 12th century AD, which improved further with the Mughals. Bankers were accepted as guarantors for the character of candidates for employment. *Sarrâfs* or saroffs acted as bankers to make remittances of money. They monopolized all monetary transactions and issued *hun î* (bill of exchange) and organized *bîmâ* (insurance of goods). By the end of Akbar's reign, a special syllabus had been devised for accountants. Books on *siyâq* (accountancy) were also written.

### Rajasthan and Bahi-Khata System

Rajasthan was an important trade centre due to trade routes to Gujarat, Surat, Kabul, Lahore, Ajmer, etc. It had a developed accountancy due to give-and-take credit system of the *mâr wâfîs*. The business records of *mâr wâfî* houses provide information on record-keeping and bookkeeping. Indian system of bookkeeping, called *bahî-khâtâ* recorded the two aspects of each event. Occidental historians referred to *bahî-khâtâ* as single-entry bookkeeping. It is simple in operation and actually a double-entry system for *vâstavik* (real), *avâstavik* (nominal) and *vyaktigat* (personal) accounts. This *Talpat* or *ânka[â-bahî* (trial balance) is prepared to test the arithmetical accuracy of the account books. The compilation of *pakkâ chimhâ* (balance sheet) is the itemized list of assets, liabilities, and proprietorship of a business at a given date. It marks the end of the periodic accounting process. The language used in *bahîs* is *Mu[îâ*, also known as *Sarâfî* or *Mahâjanî*. Since it can not be easily read and understood, it gave the *bahîs* a semblance of secrecy.

Luca Pacioli: A Friar and Mathematician from Italy  
Charge-discharge system of accounting was prevalent in European governments during 13th to 15th century, while Indians were using the bahî-khata system. Luca Pacioli revolutionised accounting methods of the western accountants

through his treatise *Summa de Arithmetica, Geometria, Proportioni et Proportionalita* (Everything about Arithmetic, Geometry, and Proportions) published in 1494, which contained 36 short chapters on double-entry bookkeeping, entitled *De Computis et Scripturis* (Of Reckonings and Writings). It served as the only textbook on accounting for more than a century ahead. He described the use of journals and ledgers, and warned that a person should not go to sleep at night until the debits equalled the credits. Although Benedetto Cotrugli Raueo had already written an account of double-entry system of bookkeeping, *Della Mercatura et del Mercante Perfetto* (Of Trading and the Perfect Trader), much before Pacioli in 1458, but it got published only in 1573. While Luca is regarded as the Father of Accounting, he admittedly only codified and described the system that was in vogue in Venice.

### Advent of Europeans

During 17th century, number of European factories increased in India. Changes in economic relations among classes promoted the use of writing, accountancy and the land holders knew the importance of the village accounts books. State revenue managers drew on commercial techniques developed by Hindu and Jain merchants.

### Auditing Practices

Audit it is the most significant aspect of the accountant's profile. It is a process to assess the credibility in the financial statements of a company. Before 1500 AD, nearly all accounting was concerned with accounting for the activities of government. The objective was to detect fraud and to minimize the erroneous recording of transactions. The industrial revolution (1750-1850 AD) changed the regime of management from owners to professional managers that led to a demand of independent auditors during 1850-1905 AD. Thereafter the concept of independent auditor's report emerged.

## III Modern India

### Evolution of Companies Act in India

Company rule in India effectively began in 1757 after the Battle of Plassey. The industrial revolution and the rise of capitalism accelerated further

developments in accountancy in 19th and 20th century. Non-mandatory balance sheet format contained in this Act continued to be used till the Indian Companies Act, 1882, which underwent amendments in the subsequent years. Up to 1913, any respectable person could be appointed as an auditor of a joint stock company. Under the Indian Companies Act, 1913, Audit was made compulsory and auditing profession got statutory recognition. In 1930, the Government of India exercised control over the members in practice by maintaining a register of accountants. The Indian Companies (Amendment) Act, 1930, made provision for the constitution of an Indian Accountancy Board. This Act also laid down the functions of the Board.

### Indian Accountancy Board

Indian Accountancy Board was set up in 1932, with Shri M.L. Tannan as the Secretary and Mr. J.C.B. Drake as the President.

### Debate over the Title of Chartered

A systematic attempt to secure the appellation, Chartered Accountant, for the members of the accounting profession in India took place during the discussions on the Companies (Amendment) Bill, which was introduced in the Legislative Assembly on March 23, 1936. An autonomous institution of accountants was created with power to grant degrees and designations done in 1948. In its final meeting held on June 9-11, 1948, it was decided that the special Act would be preferably called the Chartered Accountants Act. In its report on July 4, 1948, it said that accountants in India would be called Chartered Accountants. **The Institute Born!**

The Institute of Chartered Accountants of India was eventually set up on July 1, 1949. Its first Council was inaugurated by the Hon'ble Commerce Minister Shri K. C. Neogy on August 15, 1949. Out of fifteen elected members, 11 had been the members of the Indian Accountancy Board.

Shri G.P. Kapadia and Shri G. Basu were elected President and Vice-President respectively and unanimously. The Government of India appointed Shri S. Venkataraman as the first Secretary to the Council.

# Understanding the new structure of GAAP on Financial Instruments

\* Dr Kamal Gupta and \*\*CA. Archana Bhutani



In the recent times the number, variety and complexity of financial instruments have increased manifold. There are financial instruments which have characteristics of both a liability and equity. Then there are complex financial instruments like forward contracts, options, hedges, swaps and other derivatives. Accounting for financial instruments therefore presents complex issues on:

When to recognise?

How to measure?

How to present in the financial statements?

What disclosures to make?

Prior to introduction of AS 30-32, there were a number of pronouncements, each dealing with a specific kind of financial instrument or with aspects relating thereto, e.g.,

- AS 13 (deals with investments)
- AS 11 (deals with forex)
- AS 16 Borrowing Costs
- GN on Equity Index and Equity Stock Futures and Options
- GN on Securitisation
- GN on Guarantees and Counter-Guarantees given by Companies
- GN on Accounting for Investments in Financial Statements of Mutual Funds

There are three new accounting standards, each dealing with specific aspects of accounting for financial instruments

- AS 30 – Financial Instruments: Recognition and Measurement
- AS 31 – Financial Instruments: Presentation
- AS 32 – Financial Instruments: Disclosures

The standards (based on the corresponding international standards prior to recent revisions) are recommendatory/mandatory for accounting periods commencing 1 April 2009/2011. It should be noted that the four guidance notes stated above stand withdrawn on AS 30 becoming recommendatory.

These standards introduce new requirements for the recognition, derecognition, measurement and presentation of financial instruments. They also challenge many of traditional accounting principles and practices. They have a major impact on arguably more than half the balance sheet subject to changes in laws/regulations rules and guidelines

- Presentation, i.e. whether to be classified as equity or liability (e.g. convertible debt)
- Measurement (Initial recognition and subsequent measurement)
- Impairment
- Derecognition

- Hedge accounting (application of hedge accounting is optional, not mandatory)

This note discusses the broad and significant impact of AS 30-32 at a conceptual level on various financial items.

## Classification - Liability or equity

At present, the form of an instrument governs its classification as liability or equity (the term 'equity' is broader than 'equity shares' or 'equity share capital') e.g.:

- A debenture compulsorily convertible into equity share(s) classified as liability until conversion
- On the other hand, a preference share compulsorily redeemable after, say, just one year is classified as equity until redemption

## Impact of AS 30-32

The classification of financial instrument as either a financial liability (debt) or equity is governed by the contractual arrangement's substance rather than its legal form. An instrument is debt when the issuer is or can be required to deliver wither cash or another financial asset to the holder. This is the critical feature that distinguishes debt from equity. An instrument is classified as equity when it represents a residual interest in the issuer's net assets. For e.g.:

- A zero coupon debenture compulsorily convertible into equity share(s) is classified as equity
- Preference shares are classified as a financial liability unless all following conditions are met:
  - they are not redeemable on a specific date
  - they are not redeemable at the option of the holder
  - dividend payments are discretionary
- An INR denominated optionally convertible bond/preference share etc will be considered as a compound instrument. Thus, the face value of the instrument will be bifurcated into equity and liability component.

When allocating the initial carrying amount of a compound instrument to the underlying financial liability and the equity components, an entity first determines the fair value of the liability component, including any embedded derivatives, whether or not they have to be accounted for separately. The fair value of the liability component is determined by reference to the fair value of a similar stand-alone debt instrument (including any embedded non-equity derivatives). The amount allocated to the equity component is the residual after deducting the fair value of the financial liability component from the fair value of the entire compound instrument.

On conversion of a convertible instrument, which is a compound instrument, the entity derecognises the

*\*The authors are members of ICAI. (\*Mem.No. 009844 \*\* 096123)*

liability component that is extinguished when the conversion feature is exercised, and recognises the same amount as equity. The original equity component remains as equity, although it may be transferred within equity. No gain or loss is recognised in profit or loss.

The treatment of interest, dividends, losses and gains should follow the classification of the underlying instrument. Therefore amounts paid on instruments classified as equity should be treated as distributions to owners. Amounts paid on instruments classified as a liability should be reported as an expense in the income statement.

#### **Transaction Costs: Issue of equity instrument**

At present, expenses on issue of shares are recognised in the profit and loss account. Schedule VI includes 'expenses including commission or brokerage on underwriting or subscription of shares or debentures' under 'miscellaneous expenditure' in the balance sheet. Since accounting for expenses on issue of shares is not covered by AS 26, a company can defer and amortise (through profit and loss account) such costs. Further, under section 78, securities premium account can also be utilised for writing off the expenses of issue of shares

#### *Impact of AS 30-32*

Transaction costs, net of any related income tax benefit, of an equity transaction will be recognised directly in equity

#### **Transaction costs: Issue of debt instrument**

The treatment at present is as below:

- Section 78 does not require but permits the use of Securities Premium Account for writing off expenses of issuing debentures
- Schedule VI includes 'expenses including commission or brokerage on underwriting or subscription of shares or debentures' under 'miscellaneous expenditure' in the balance sheet

#### *Impact of AS 30-32*

Transaction costs of raising debt are adjusted in the initial measurement of related liability. For example, if Rs. 2 crore is issue expenses of debentures of Rs.200 crore, the initial liability would be measured at Rs.198 crore. Suppose, redemption value is also Rs.200 crore. A sum of Rs. 2 crore would be recognised over the period till redemption using effective interest method.

#### **Classification of financial assets and liabilities**

At present, the classification is based on the requirements of the Companies Act, 1956, Schedule VI and AS 13 which are different. Classification has impact on valuation.

#### **Impact of AS 30-32**

Under AS 30, all derivatives (whether financial assets or financial liabilities) are classified as 'held for trading' except financial guarantee contracts and designated and effective hedging instruments

For non-derivative financial assets, there is a four-way classification

- Financial assets at fair value through profit or loss
- Held-to-maturity (HTM) investments
- Available-for-sale financial assets
- Loan and receivables

Financial liabilities are classified as either financial liabilities at fair value through profit or loss or other financial liabilities (at amortised cost).

The 'at fair value through profit or loss' category includes financial assets (and financial liabilities) that are held for

trading, and those that the entity chooses to so designate (provided that they qualify for such designation) upon initial recognition. Subsequent transfers into or out of this category are prohibited. HTM investments are non-derivative financial assets with fixed or determinable payments and fixed maturity that an entity has positive intention and ability to hold to maturity. Equity instruments cannot be classified as HTM investments. An entity is generally barred from classifying any financial asset as HTM if it has sold or reclassified a significant portion of its HTM investments before their maturity during the current financial year or two preceding financial years.

#### **Other developments**

IASB has decided to replace IAS 39 in three phases – classification and measurement, impairment methodology, and hedge accounting. It has issued IFRS 9 is the first part of Phase 1. IFRS 9 deals only with limited aspects of accounting for financial assets (not financial liabilities) falling within the scope of present IAS 39 – initial recognition, classification (and reclassification) and measurement (initial as well as subsequent). IFRS 9 would eventually replace entire IAS 39 with addition of further chapters.

#### **Impact of IFRS 9**

*As per IFRS 9, classification for assets will be in two categories – fair value and at amortised cost. Assets held by an entity under a business model designed to collect payments of solely principal and interest are permitted to be held at amortised cost. Many assets classified as loans and receivables under AS 30-32 may require fair value accounting under IFRS 9. A frequent pattern of selling assets will conflict with the criteria required for amortised cost accounting. All other assets are held at fair value. Equity investments that are non-trading in nature can be classified as at fair value through Other Comprehensive Income (OCI) but this is an irrevocable choice and all unrealised and realised gains and losses on these investments are recognised only in OCI.*

*As per the latest exposure draft liabilities will be at amortised cost or at Fair Value through Profit & Loss (FVPL). If they are at FVPL, then the effect of the entities own credit spread will be excluded from the impact on profit and loss*

#### **Recognition and measurement: present position**

The present Indian GAAP on recognition and measurement, contained in respective accounting standards, essentially follow a cost-based approach e.g.

- Current investments to be valued at lower of cost and fair value
- Long-term investments (debt or equity instruments) to be valued at cost, subject to recognition of any other-than-temporary diminution in value

In contrast, the normal valuation rule in AS 30 is 'fair value'. Cost or amortised cost is the valuation basis only in certain limited, specified cases. Remeasurement to fair value would be required to be performed at each balance sheet date. Fair valuation differences, whether losses or gains, are general required to be recognised in profit and loss account barring some exceptions, e.g. in respect of financial assets classified as available for sale where they are taken directly to equity (and recycled later to profit and loss account). All equity investments are held at fair value unless they are unquoted and there is no reliable measure of fair value.

*Under IFRS 9, all equity investments will be at fair value; the exemption under AS 30-32 for non reliable measurement has been removed.*

### Accounting for interest free loan

Consider a case where A Ltd. lends Rs. 150 million to B Ltd., its major supplier, receivable after a period of five years. In view of significance of supplies made by B Ltd., the loan has been given interest-free by A Ltd. At the date of lending, the market interest rate for a similar loan is 10% per year. The present value of Rs. 150 million receivable after 5 years discounted at 10% is Rs. 93.1 million

As per AS 30, the loan should be recognised initially in the books of A Ltd. At Rs 93.1 million. The difference between the nominal amount of loan (Rs.150 million) and the amount recognised as loan asset (Rs.93.1million) should be charged immediately to profit & loss account unless it qualifies to be recognised as an asset as discussed below.

In the present case, whether the difference represents an asset would need to be determined by applying AS 26. For example, if the detailed facts of the case are that there is a non-cancellable contract between the company and the supplier for supply of a specified quantity in each of the next five years, the difference of Rs. 56.9 million represents an intangible asset. This asset would be amortised over the five-year period in accordance with the pattern of consumption of benefits (e.g. quantities of supplies)

#### Accounting for interest free loan – at present

- Schedule VI disclosure requirements relating to loans and advances have not been amended and it can be strongly argued that in the absence of specific recognition to concept of discounting therein or in accounting standards notified under the Companies Act, nominal (i.e. undiscounted) amounts should be reported
- Moreover, such loans are usually given to related parties and one could argue that by the process of discounting, the relevant loans are being understated

### De-recognition

At present, there are no general principles on derecognition of financial assets and liabilities. ICAI's guidance note is on the allied subject of securitisation. RBI has prescribed specific guidelines for derecognition of assets and recognition of related gains/liabilities by NBFCs and Banks. Pending issuance of more specific authoritative literature, these are applied to those situations also where a sale of assets takes place otherwise than in a securitisation transaction.

In view of the above, generally, the financial assets are derecognised when the legal ownership and the control relating to an asset/s have been transferred. For NBFCs and Banks, the additional conditions prescribed by the RBI are required to be met. RBI does not permit upfront recognition of gain even in case of true sale and instead requires the gain to be amortised.

#### Impact of AS 30-32

A financial instrument (including derivative) or a portion thereof should be derecognised when:

- Financial asset - Contractual rights to the cash flows from that financial asset have expired or the financial asset transferred
- Financial liability -Obligation is extinguished: when obligation is paid off, cancelled or expired

A sale and repurchase transaction where repurchase price is fixed or a securities lending agreement would normally not result in derecognition of the financial asset. For most securitisation and certain direct assignment transactions conducted where there is a significant level of credit

enhancement provided by the transferor, de-recognition under AS 30-32 may not be possible as the underlying exposure to risks and rewards of the asset/s have not been transferred.

The de-recognition rules of AS 30 are strict. De-recognition principles may have a big impact on...

- Securitisation
- Securities lending
- Repurchase agreements
- Partial transfers of assets/liabilities,
- Transfers involving special purpose entities
- Derecognition coupled with a new asset or liability

#### Example: De-recognition of financial liability

An entity has a deferred sales tax obligation to a state government. It enters into an arrangement with a bank whereby the bank agrees to discharge the liability at the future date in return for payment of a specified sum to it by the entity presently. The entity does not derecognise its liability unless it is legally discharged from primary responsibility for the liability by the state government. However, if the state government itself extinguishes the liability on immediate payment of the present value of the obligation, the liability is derecognised on such payment.

#### De-recognition: example of repo

- A typical repo is in substance a securities lending arrangement for a specific duration
- The risks and rewards of the underlying security continue to remain with the seller
- The underlying security would not be derecognised by the 'seller' under the repo
- The above may have implications for banks

In case of buy-back of own shares, the nominal value should be deducted from share capital. Difference between the consideration paid and the nominal value should be recognised directly in reserves and surplus.

### Derivatives and hedge accounting

At present, the relevant guidance on derivatives and hedge accounting is provided by:

- AS 11(mandatory)
- ICAI's announcement of March 2008
- AS 30 (which is at present recommendatory)
- Guidance Note on Accounting for Equity Index and Equity Stock Futures and Options

AS 11 deals with only the following forward exchange contracts:

#### (a) Hedges of recognised assets or liabilities;

The premium or discount arising at the inception of such a forward exchange contract is amortised as expense or income over the life of the contract. Exchange difference on such a contract is recognised in the statement of profit and loss in the reporting period in which the exchange rates change.

#### (b) Held for trading or speculative purposes

The premium or discount on the contract is ignored and at each balance sheet date, the value of the contract is marked to its current market value and the gain or loss is recognised.

AS 11 does not cover forward contracts for highly probable forecast transactions and firm commitments. These were accounted for as per ICAI's March 2008 announcement.

ICAI's March 2008 announcement requires that either any MTM loss on such a forward contract should be recognised in profit and loss account or the principles laid down in AS 30 should be followed whereby all derivatives should be marked to market. Under the first approach, no gains on the related derivatives can be recognised while under the AS 30 approach both, gains and losses will have to be recognised.

Other derivatives such as interest rate swaps are also required to be treated in a like manner.

With its March 2009 amendment, AS 11 now also gives a choice (available for a limited period of time) of following an alternative treatment of exchange differences relating to long-term foreign currency monetary items.

#### Impact of AS 30-32

Under AS 30, accounting for forward contracts for even existing assets (e.g. trade debtors) or existing liabilities would be different than that under AS 11

- All derivatives (including some embedded derivatives), whether categorised as held for trading or as hedging instruments, will be required to be measured at fair value in the balance sheet (subject to certain exceptions). Unless they qualify as hedging instruments, all fair value gains and losses are recognised immediately in profit and loss account.
- In order to qualify for hedge accounting, an entity must designate, at inception, its hedge relationships and document how it will measure effectiveness. Each individual relationship between a hedging financial instrument and the fair value of the hedged asset, or liability or its future cash flow must be documented separately. Such a relationship may be established at micro or portfolio level. Barring limited exceptions, only a derivative can be a hedging instrument.
- Hedge accounting is permitted provided that at each balance sheet date there is an expectation that the hedge will be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated. The actual effectiveness needs to be established at each balance sheet date.
- There are two hedge accounting models: the fair value hedge, and the cash flow hedge. The hedge of a net investment in a foreign operation is accounted for in the same way as cash flow hedge. The appropriate accounting model for a hedge relationship depends on the nature of the item being hedged.

A non-derivative contract can have certain characteristics that cause it to behave like a derivative. These characteristics need to be evaluated to determine whether they should be separated from the financial instrument and accounted for separately as an embedded derivative.

#### Embedded derivatives under AS 30

An embedded derivative is a component of a hybrid (combined) instrument that also includes a non-derivative host contract, where some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative. Embedded derivative is required to be separated only if all the following conditions are satisfied:

- The embedded derivative is not closely related to economic characteristics and risks of the host (e.g. leverage, optionality feature);
- Embedded derivative would be a derivative if it was freestanding; and
- The host contract is not carried at fair value through profit or loss

#### Accounting of embedded derivatives following separation:

- Host: apply rules of AS 30 or other applicable standard if host is not a financial instrument
- Derivative: measure the separated derivative at fair value through profit or loss

#### Accounting of embedded derivatives when separation difficult

- If it is difficult to determine the fair value of the embedded derivative, it is deemed to be the difference between the fair value of the combined (hybrid) instrument and the fair value of the host contract

#### Accounting when separation is not possible:

- If the embedded derivative cannot be reliably identified and measured, the entire combined contract is accounted for as a financial instrument at fair value

*Under IFRS 9, embedded derivatives in financial instruments will not require separation. Instead there will be a consideration of whether the asset / liability as a whole meet the criteria for amortised cost accounting. In most cases, this will fail and therefore financial instruments with embedded derivatives are most likely going to require to be accounted for at fair value. Other areas of derivative and hedge accounting have not been addressed yet under IFRS 9.*

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### Regional Conference of CA Students

Theme : Visualize Opportunities in Challenges

Hosted by : Baroda Branch of WIRC of ICAI & WICASA. Date : Friday, July 9th, & Saturday, July 10th, 2010.

Venue : Hotel Surya Palace, Sayajigunj, Vadodara.

For more details, Students may contact -The Convenor

WIRC CA. Students' Regional Conference,

Baroda Branch of WIRC of ICAI.

"ICAI BHAWAN", Kalali - Tandajla Road, Atladra, Vadodara. Tel.: 0265-2681115

# IFRS 3 - Business Combination: In Brief

\*CA.Yagnesh Desai



## Objective

The objective of International Financial Reporting Standard - 3 (IFRS 3) is to set out the accounting and disclosure requirements for a business combination, to improve the relevance, reliability and comparability of information presented in the financial statements, which is achieved by establishing principles and requirements as to how **an acquirer** should



(a) recognise and measure :

- (i) in **its** financial statements the identifiable assets acquired, the liabilities assumed and any non-controlling interest (minority interest) in the **acquiree**;
- (ii) the goodwill acquired in the business combination or a gain from a bargain purchase; (“negative goodwill”) and

(b) determine what information to disclose.

Since all accounting in business combination need to be done from the point of view of **an acquirer**, its very important to determine who is **an acquirer**.

## Core Principle

An **acquirer** of a **business** recognises the assets acquired and liabilities assumed at their **acquisition-date fair values** and discloses relevant information nature and financial effects of the acquisition.

## What is Business Combination ?

A transaction or other event that results in **an acquirer** obtaining **control** over one or more **businesses**.

## Scope & Exclusion

Transactions or other events that meet the definition of a business combination are subject to IFRS 3. This standard is **not** applicable to formation of a joint venture, acquisition of an asset or group of assets that do **not** constitute business, and combinations between entities or businesses under common control.

## Application

Each business combination should be accounted for using acquisition method, (earlier known as “purchase method”) which involves following steps :

1. Identifying **An Acquirer** – One of the parties to the transaction is identified as the acquirer, other(s) being **acquiree(s)**.
2. Determining **acquisition date**
3. Recognising and measuring :
  - (i) The identifiable assets acquired, the liabilities assumed and any non-controlling interest in the **acquiree**;
  - (ii) goodwill or a gain from a bargain purchase.

## Pooling of interest method not permitted under IFRS 3

An entity should assess whether a particular transaction is a business combination by applying the definition of a business combination, i.e. has the entity gained control of one or more businesses for making profit ?

*\*The author is a member of ICAI (Mem.No. 034975)*

Control of an entity is where one party (or a number of parties) has the power over another to “**govern its financial and operating policies so as to obtain the benefits from its activities**”.

### There will be only one acquirer

Lots of deliberation and assessment required to assess, whether particular transaction constitute business or just a bundle of assets ?

For application of IFRS 3, emphasis is on **acquisition of business** rather than an asset or group of assets. Purchase of an asset or group of assets, if they do not constitute business, do not give rise to goodwill, as also not covered by IFRS 3.

In a straightforward business combination one entity will acquire another, resulting in a parent-subsidiary relationship.

Business combination can be structured in numbers of ways, for example :

- one or more businesses become subsidiaries of an acquirer;
- one entity transfers its net asset to another entity;
- all entities that are party to the business combination transfer their net assets to a newly formed entity; or
- a group of former owners of one of the combining entities obtains control of the combined entity.
- By contract alone without the transfer of consideration, such as when
  - a. An acquiree business repurchases enough of its own shares to cause one of its existing investors (the acquirer) to obtain control over it.
  - b. There is a lapse of minority veto rights that had previously prevented the acquirer from controlling an acquiree in which it held a majority voting interest.
  - c. An acquirer and acquiree contractually agree to combine their businesses without a transfer of consideration between them.

**There are several issues like contingent consideration and subsequent measurement etc. which merit detailed deliberation in business combination.**

## Steps in Business Combination

### 1. Identify an acquirer

IFRS 3(R) strongly emphasizes the concept that every business combination has an acquirer. And it is presumed that it will always possible to identify an acquirer.

Presuming that the transaction or event constitutes business, we need to ascertain who is **an Acquirer**, as it is **an acquirer** who has to **recognise and measure** in **its** financial statements, identifiable assets and liabilities of **acquiree** as also goodwill or gain in bargain purchase.

**An acquirer** is the entity that obtains control of the entity – **the acquiree**. The power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

In general, control is presumed to exist when the parent owns, directly or indirectly, **a majority of the voting power** of another entity, this is not an absolute rule to be applied in all cases. However, in exceptional circumstances, it can be clearly demonstrated that majority ownership does not constitute control, but rather that the minority ownership may constitute control.

When it is not possible to clearly identify an acquirer, one has to take into account the facts and circumstances surrounding the transaction and events and follow the indicators given in the standard, to identify who is an acquirer, like

1. *Relative size*
2. *Initiator of the transaction*
3. *Roll-ups or put-together transactions*
4. *Non-equity consideration*
5. *Exchange of equity interest.*

In a reverse acquisition, the entity issuing equity interests is legally the acquirer, but for accounting purposes is considered the acquiree. And accounting is done from the perspective of **accounting acquirer** ( legal acquiree). Accounting for reverse acquisition are bit complex.

### What is Reverse Acquisition ?

When a private entity wants to become a public entity but does not want to register its equity shares. In such case, private entity approaches a public entity, i.e. the one which is listed, to acquire its (private entity's) equity interests in exchange for the equity interests of the public entity. Accounting for business combination is done from the perspective of accounting acquirer and NOT legal acquirer. In Indian context, Kingfisher is accounting acquirer and Air Deccan is a legal acquirer.

### 2 Determining the Acquisition Date

Measurement of assets, liabilities, intangible assets, non-controlling interest, recognition of goodwill etc in case of business combination is acquisition-date sensitive. Hence it is very critical to determine acquisition date.

The acquisition date is defined as being **'the date on which the acquirer obtains control of the acquiree'**, which is normally the date on which the acquirer legally transfers the consideration for the business. It is possible for control to pass to the acquirer before or after this date. Where several dates are key to the business combination, it is the date on which control passes that determines the date on which the acquisition occurs. Where control is acquired by way of contractual arrangement, the date on which an acquirer has obtained control depends on surrounding facts and circumstances. Under IGAAP date of amalgamation is defined in the scheme or by the court's verdict.

Step 3 Recognize and measure the identifiable tangible and intangible assets acquired and liabilities assumed.

#### Recognition

At the **acquisition date**, the identifiable assets acquired and liabilities assumed must meet the definitions of assets and liabilities as set forth in Framework. Such assets and liabilities recognized must be part of the exchange transaction between the acquirer and the acquiree and **not** part of a separate transaction or transactions.

It is possible that acquiree may not have recognised certain intangible assets, as they may have been generated internally. But from the standpoint of an acquirer, such intangible assets (e.g., patents, customer lists) may be recognised by acquirer, the

one which are separable from the entity or acquired by law or contractual agreement.

#### Measurement of Assets and Liabilities

With the exception of followings, in general, the measurement principle is that **an acquirer** measures the identifiable tangible and intangible assets acquired, and the liabilities assumed, **at their fair values on the acquisition date.**

- i) contingent liabilities – IAS 37
- ii) income taxes – IAS 12
- iii) employee benefits – IAS 19
- iv) indemnification assets.
- v) reacquired rights.
- vi) share-based payment awards – IFRS 2
- vii) assets held for sale IFRS 5

Above items covered by specific standard will be measured as per the applicable standards.

#### Measure Non Controlling Interest in the Acquiree

Non-controlling interest arising in business combination can be measured in two ways :

- (1) to measure the non-controlling interest at fair value (recognizing the acquired business at fair value), or
- (2) to measure the non-controlling interest at the non-controlling interest's share of the acquiree's net assets.

The choice of the method to measure the non-controlling interest should be made separately for each business combination rather than as an accounting policy.

#### Measure Consideration Transferred

The consideration transferred in a business combination is the total of the fair values at the acquisition date of the consideration given by the acquirer.

The consideration transferred may take a number of forms, such as:

- cash or other assets given up;
- liabilities assumed, but not future losses.
- the issue of equity instruments, such as ordinary shares.

## Recognition and measurement of goodwill

Final step in applying the acquisition method is the measurement of goodwill or a gain from a bargain purchase. Goodwill represents an intangible that is not specifically identifiable.

It results from situations when the amount the acquirer is willing to pay to obtain its controlling interest exceeds the aggregate recognized values of the net assets acquired measured following the principles of IFRS 3.

Goodwill/gain from bargain purchase is measured as under.

### Excess of aggregate of :

A : The consideration transferred, the amount of any non-controlling interest, if any, and if the business combination has been achieved in stages, then the consideration will also include the fair value of the acquirer's previously held equity interests in the acquiree at the acquisition date.

### OVER

B. The identifiable assets and liabilities recognised.

If  $A > B$ , it results in goodwill, If  $B > A$ , it results in gain from bargain purchase.

After initial recognition, goodwill **should not be amortised** but must be tested for impairment at least **annually**, as also whenever there are indicators of impairment.

Though recognised as an asset, goodwill should not be revalued, and therefore it will either be carried in the statement of financial position at the amount recognised on initial recognition or it will be reduced as impairment losses are recognised.

### Gain from Bargain Purchase

Such a situation may however arise where the seller has to raise funds urgently (a "forced sale"). Gain from bargain purchase to be recognised in profit or loss account (and not in capital reserve as per Indian GAAP).

When gain from bargain purchase arises rarely, in such a case, which could perhaps have arisen as a result of an error in the measurement of the acquiree's net assets, the non-controlling interest or the consideration transferred. Acquirer should reassess the recognition of the identifiable net assets, liabilities assumed, non-controlling interest, and consideration transferred.

## Measurement Period – One Year window

Many times management of the acquirer, despite the best of efforts made by an acquirer, do not get the required information, to complete its assessment of the identifiable assets and liabilities acquired by the end of the reporting period in which the combination takes place.

In such circumstances, the acquirer is required to make a provisional assessment at the end of the first reporting period. These provisional values should subsequently be finalised within the measurement period, which is maximum one year reckoned from acquisition date, and adjustments should be made directly to the identifiable net assets and the consideration transferred – retrospectively. This will entail restatement of previous year's statements.

After the measurement period ends, the acquirer shall revise the accounting for a business combination only to correct an error in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

### IFRS 3 and First Time Adoption of IFRS

IFRS 3 is covered by one of the voluntary exemptions from retrospective application, granted by the IFRS 1. If any entity opts, it may not apply business combinations retrospectively. However, if at all an entity chooses to apply business combination retrospectively, it should apply IFRS 3, for business combinations occurring thereafter.

### Comparison with I GAAP

Under IGAAP - AS 14 covers only amalgamation and not acquisition, as also only pooling of interest method is permitted. One year measurement period is not permitted under AS 14. No detailed provisions for reverse acquisition.

There are several issues like contingent consideration and subsequent measurement etc. which merit detailed deliberation in business combination.

This standard will pose many challenges for accounting fraternity, as this standard is based on judgement and not rule based and lots deliberation will be required which need to be weighed in view of facts and circumstances.

## De-recognition of Financial Assets

\*CA. C V Sajan



**G**lobal financial crisis of 2008 had its genesis from higher financial leverages taken by banks and other financial institutions, beyond their risk taking capacity. Excessive lending, beyond the capital capacity, had exposed the lenders to high risks, more particularly in a market where repayments slackened and defaults increased. Regulators were caught off guard, because the accounting methods used for leverages were innovative under which loan receivables were derecognized from books of lenders while funds were raised against such receivables. This brought to the fore the importance of compliance of de-recognition principles. An analysis of de-recognition principles, as laid down in International Financial Reporting Standards (IFRS) is attempted in this article.

The International Financial Reporting Standard that deals with measurement and recognition principles of financial instruments, is IAS

39( This IAS is under revision as IFRS 9 will replace this IAS by the end of 2010, however the principles discussed in this article are unlikely to change even in IFRS 9). This IAS in its present form deals with the following.

- (a) Recognition criterion for financial assets and financial liabilities
- (b) Initial measurement principles related to financial assets and financial liabilities
- (c) Subsequent measurement principles and classification for that purpose
- (d) De-recognition principles

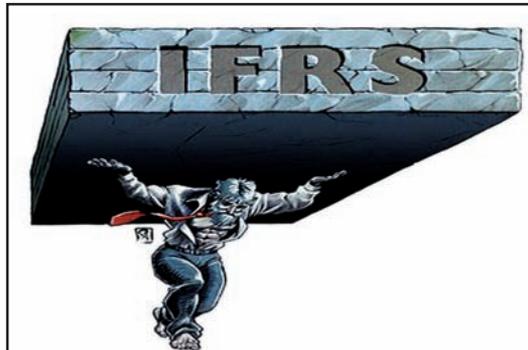
- (e) Impairment accounting related to financial assets
- (f) Embedded derivatives and their accounting
- (g) Hedge accounting principles and
- (h) Other aspects that include treatment of transaction cost, guidance on fair value measure and amortised cost, non financial items accounted for as financial items etc.

IAS 39 clearly lays down the principles to be followed while derecognizing a financial asset from the books of accounts of the lender ( originating entity in a securitisation transaction).

Raising funds against loan receivables is a common financing mechanism, followed by banks and non banking companies. Securitisation is one of the common methods used for this, where in the financier takes over the loan receivables in substance.

Accounting followed for securitisation results in de-recognition of receivables from the books of accounts of the entity that raises the funds, as the funds received replaces the receivables, rather than reflecting such funds as a liability. However in reality, the financier may just be funding against the receivables rather than taking over the receivables and related risks and therefore de-recognizing the receivables from the books of the originating entity may not be appropriate in all cases. In other words judgement based on facts of funding only can vouch for correctness of accounting.

*\*The author is a member of ICAI (Mem.No. 092146)*



Principles of de-recognition shall be applied, to the financial statements only after consolidating all subsidiaries, including any Special Purpose entities, according to IAS 39. If the special purpose entities are not in the control of the entity then they are not required to be included for consolidation.

The first test for de-recognition is whether the rights to the cash flows from the asset is expired or not . If the originating entity has lost its right to cash flow from receivables, then it is entitled to derecognize the assets and replace it with funds received against it.

In normal securitisation transactions, the originating entity may be constrained to retain the right to cash flow with it . For instance a Non Banking Finance Company having tied up with an investment banker to raise finance against the truck loan receivables. Here although the investment banker may be extending finance to the NBFC, it would not like to keep track of the truck loan receivables. Rather its interest may be to earn a respectable return from the funding made.

Therefore, although the right to cash flow from the truck loan receivables, is transferred to the investment banker, yet the NBFC may be involving itself in the process of recovering the loan receivables from its borrowers. This is described as a continuing involvement approach.

Under the continuing involvement approach, the originating entity will take efforts to collect instalments from its borrowers and will transfer those funds immediately to the financier. Here the originating entity's involvement is limited to the facilitation for the convenience of the financier. Even if there is a continuing involvement of the entity, it can be a case where right to cash flow has been transferred . When it is certain that right to cash flow has been transferred to the financier , the originating entity is entitled to derecognize the assets from its financial statements. Even if there is continued involvement for the originating entity

to facilitate collection of instalments and its transfer, and for which a special purpose entity(SPE) is created, such SPE need not be considered to be under the control of the originating entity, when right to cash flow has actually been transferred. As a result, the SPE need not be consolidated with the originating entity and de-recognition from the financial statement of the originating entity takes place, by shifting the loan receivables to the SPE.

There may be situation where it can not be concluded whether the right to cash flow is transferred by originating entity to the financing entity or that it is still retained by the originating entity. If so, in order to test the eligibility for de-recognition, it has to be ascertained whether the entity has transferred substantially all risks and rewards, to the financier or not. Suppose the originating entity has no responsibility to make good the financing agency, in the event of shortfall in instalment collection from underlying receivables, say in the above quoted example truck loan receivables. That means the financing agency has taken all the

risks up on it and therefore the originating entity is entitled to derecognize the assets from its financial statements.

There may be instances where the agreement between the originating entity and the financing company has several clauses that have the effect of restricting losses and profits to the financing company . Such an agreement in effect means that the financier had not taken up all the risks related to the receivables, against which it financed , up on itself. In other words risks and rewards remained with the originating agency. In such cases it would be incorrect to derecognize the loan receivables from the financial statement of the originating entity. In case special purpose entity is created and loan receivables are parked in such an SPE, by consolidation, all those receivables will become part of the financial statement of the originating entity.

*Just as recognition principles are very important, de-recognition principles are equally important in presenting accurate picture of leverages, to which an entity is exposed.*

There could also be cases where despite best analysis, it is difficult to conclude whether the risks and rewards are retained by the originating entity or that it has been shifted to the financier, and therefore the 'risk reward test' can not be successfully applied to determine the eligibility for de-recognition from the books of the originating entity. In such cases, it has to be tested whether the originating entity has retained control of the asset or not. In case control is with the originating entity it shall continue to recognize the asset (of receivables) in its books. In such a case, the amount that is raised as finance is a liability in the books

of the originating entity and it has to be presented at the actual amount received from finance.

Apart from securitisation, factoring, bill discounting etc., also are financing transactions that, according to substance of transaction, generally do not comply with de-recognition principles and therefore have to be reflected as liabilities. Just as recognition principles are very important, de-recognition principles are equally important in presenting accurate picture of leverages, to which an entity is exposed. Accounting professionals have a duty to ensure compliance of these provisions meticulously.

## Honourable Chief Justice of India Shri S H Kapadia *A Guiding Spirit*



Recently, Hon'ble Justice S H Kapadia, the senior most judge of the Supreme Court, has been appointed as the 38th Chief Justice of India. He is a live example of how a person with an indomitable will and a resolute mind can attain his aim of life. His childhood dream was to become a lawyer and today he is the Chief Justice of India.

Shri Kapadia belongs to a genteel lower middle-class family. His father was a clerk in a defence establishment and his mother a homemaker. Shri Kapadia completed his BA and LLB and immediately began working. In a letter written to former Supreme Court judge V R Krishna Iyer he stated humbly *"I come from a poor family. I started my career as a class IV employee and the only asset I possess is integrity"*.

The young Sarosh may not have been rich but what he did possess was ambition and determination to become a judge. He became counsel for the income tax department in 1974, aged 27. He represented the Maharashtra government and several public sector undertakings (PSUs) until he was appointed a high court judge. He played an important role in the proceedings of the Joint Parliamentary Committee constituted to investigate the stock scam of 1999. In 2003, he was appointed Chief Justice of the Uttarakhand High Court and in December of that year, he was elevated to the Supreme Court, thus serving only a very short tenure as Chief Justice of a High Court.

He was also associated with a historical judgement in which a five-judge Constitutional Bench had held that the law put in the Ninth Schedule was open for judicial review.

Justice Kapadia's deep knowledge on wide ranging issues, particularly tax laws, has earned him accolades from the bench and the bar in equal measure. It is hoped that under his able guidance Indian judiciary will reach new height of success.

# Impairment of Assets under IFRS

\* CA. Amit Chugh



The notification by Ministry of Company affairs detailing the companies on which IFRS is applicable from April 1, 2010 is in line with the global momentum towards convergence of high quality financial reporting. Significant benefits can be derived from convergence to IFRS. These include enhanced comparability and reporting transparency. Migration to IFRS will also lower the cost of raising capital, as it will eliminate multiple reporting and reduce the risk premium built by investors who are not conversant with Indian GAAP unlike IFRS.



than its recoverable amount. This recoverable amount once determined needs to be compared with its carrying value to determine if there is any impairment.

With slowdown and recession looming large on the world economies including the fast paced emerging markets like India, IAS – 36 on impairment of assets has gained a lot of importance.

The standard is likely to have a huge impact on Indian enterprises based on the following facts:

IAS – 36 on Impairment of Assets is of paramount importance and needs no introduction. In principal as asset is impaired when an entity will not be able to recover that asset's balance sheet carrying value, either through using it or selling it. The impairment provisions of IFRS are explicit and if there are any circumstances that indicate any impairment indicators then a review should be undertaken of their cash generating abilities either through use or sale. Sources of such indicators can be internal or external. Some of the external sources are decline in asset's market value, adverse technological, market or economic changes, increase in interest rates etc. Internal sources can be obsolescence, physical damage, significant changes in manner in which an asset is expected to be used, internal reports that indicate the economic performance of asset would be worse than expected etc.

The purpose of review is to ensure that assets whether tangible or intangible including goodwill should not be carried at an amount which is more

- The latter part of the decade saw a significant fall in profitability, stock prices, property prices and rentals.
- A highly protective regime in the past resulted in a lot of buildup of inefficient capacities, not matching international standards. Further, globalization has exposed India to international competition, particularly from China whose cost of production is significantly lower than compared to India in many areas.
- Application of low depreciation rates and capitalization of huge pre-operative costs may have resulted in overstatement of assets carrying value and hence the possibilities of impairment are to that extent higher.
- The last decade saw investments in development of huge asset base, very often in diversified non-core businesses, which could have resulted in impairment under current conditions.

*\*The author is a member of ICAI (Mem.No. 0505224)*

- A large number of the listed enterprises in India have made losses in the last year.

The principle of fair valuation is pervasive in IFRS. There is no strong argument not to do so in the case of other assets of an enterprise. The objective of IAS – 36 is to state impaired assets at no more than their recoverable amount. An asset is impaired if its carrying amount exceeds the amount to be recovered through use or sale of the asset. If this is the case, IAS – 36 requires the enterprise to recognize an impairment loss, i.e., the amount by which the carrying amount of an asset exceeds its recoverable amount. Needless to say, if the impairment exercise suggests that the recoverable amount is greater than the carrying value, the surplus is ignored. In other words, impairment losses are recognized but future gains are not recognized.

IAS – 36 requires recoverable amount to be measured as the higher of fair value less cost to sell and value in use. Fair value is the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, after deducting any direct incremental disposal costs. Costs of disposal are incremental costs directly attributable to the disposal of an asset, excluding finance costs and income tax expense. Value in use is the present value of estimated future cash flows expected to arise from continuing use of an asset and from its disposal at the end of its useful life. As the recoverable amount is to be expressed as a present value and not in actual terms, discounting is central feature of impairment test.

Estimated future cash flows reflect assumptions that are consistent with the way the discount rate is determined. Otherwise, the effect of some assumptions will be counted twice or ignored. The discount rate is independent of the enterprise's capital structure and the way the enterprise financed the purchase of the asset because the future cash flows expected to arise from an asset do not depend on the way in which the enterprise financed the purchase of the asset. Various factors need to be borne in mind while determining the discount rate. Some of important factors to be considered are that it should always be pre-tax, consideration should be given to various risks such as country risk, currency risk, price risk and cash flow risk in determining the asset specific risk rate. Also to avoid double counting following should be kept in mind:

- The discount rate does not reflect risks for which future cash flow estimates have been adjusted.
- Estimates of future cash flows and the discount rate reflect consistent assumptions about price increases due to general inflation. Therefore, if the discount rate includes the effect of price increases due to general inflation, future cash flows are estimated in nominal terms. If the discount rate excludes the effect of price increases due to general inflation, future cash flows are estimated in real terms but include future specific price increases or decreases.
- Estimates of future cash flows should not include cash inflows or outflows from financing activities. Because the time value of money is considered by discounting the estimated future cash flows, the cash flows exclude cash inflows or outflows from financing activities.

Having determined the discount factor one needs to determine the future cash flows accurately. The cash flow forecast should include three elements:

1. Cash inflows from the continuing use of the asset;
2. The cash outflows necessary to generate these cash inflows, including cash outflows to prepare the asset for use, that can either be directly attributed, or allocated on a reasonable and consistent basis; and
3. The net cash flows, if any, that the entity may receive or pay for the disposal of the asset at the end of its useful life.

Cash flows should not just be hypothetical numbers rather projections should be based on reasonable and supportable assumptions. Aggressive assumptions are not permitted. Projections should be based on most recent budgets/forecasts and should cover a maximum period of five years, unless a longer period can be justified. Projections beyond this period should be extrapolated using a steady or declining growth rate for subsequent years, unless an increasing rate can be justified. If appropriate, the growth rate is zero or negative. The estimates should not be inconsistent with information used for other accounting purposes, such as for assessing the recoverability of a deferred tax asset. Future cash flows should be estimated for the asset in its current condition. Estimates of future cash flows should not

include estimated future cash inflows or outflows that are expected to arise from: (a) a future restructuring to which an enterprise is not yet committed; or (b) future capital expenditure that will improve or enhance the asset in excess of its originally assessed standard of performance. However effects of normal repair expenditures are considered.

Based on the above one can easily determine the value in use. The other important leg of an impairment test is the estimation of fair value less cost to sell [FVLCS]. The standard goes into detail regarding the estimation of an asset's FVLCS. The best evidence of selling price of asset under question is a binding sales agreement negotiated at arm's length. If there is no binding agreement for the asset in question, but there is an active market for assets for this type, FVLCS may be estimated from current or recent bid prices.

In reality, however, there are a few active markets as they are defined under IFRS. Consequently, most estimates of fair value will be based on estimates of market price of the asset in an arm's length transaction. This will involve consideration of the outcome of recent transactions of similar assets in the same industry. The entity will use the best information it has available at the balance sheet date to construct the price payable in an arm's length transaction between knowledgeable, willing parties.

Impairment losses will be a normal expense; therefore it will have impact like any other P&L item on distributable profits for dividend declaration, determination of limits under Companies Acceptance of Deposits Rules, determination of sickness for BIFR purposes, calculation of EPS, determination of investment limits under Section 372A, determination of profits for managerial remuneration, determination of profits for MAT purposes, etc.

In future, enterprises may apply more realistic depreciation rates in order to avoid an impairment test.

The standard is likely to have both a positive and a negative impact on M&A activities. Those enterprises that have an impaired business may

want to dispose it off in order to avoid the impairment charge. Conversely, those enterprises that want to buy a business at a price in excess of the value of the business may be weary of an impairment charge and that may influence their decision not to enter into that transaction.

Looking at the standard in detail one comes across various terms which need to be understood clearly by the companies.

We have a robust mechanism in India for impairment by virtue of AS – 28, however, there are some differences between the two standards which are as under:

- Under Indian GAAP impairment testing for intangible assets, which are not yet available for use or which have a life exceeding 10 years, is required to be done at least at the end of year. Under IFRS such testing for intangible assets which are not yet available for use or which have indefinite useful life can be done at any time during the year,

provided it is done at the same time every year.

- Under IFRS annual impairment testing is required for Goodwill acquired in a Business Combination.
- Under Indian GAAP, goodwill impairment loss recognized on account of specific external event can be reversed subsequently if subsequent external event require so and it is certain that such event shall not recur again. However, under IFRS, goodwill impairment loss once recognized cannot be reversed subsequently.

Notwithstanding the elaborate guidance provided under IAS – 36 on implementation of the standard, it is a difficult standard to apply in practice. For example discount rate, an entity is required to estimate the rate which the market would expect on an equally risky investment. In real life such information is not readily available. The standard allows a number of different methods to arrive at such rate yet it gives little concrete guidance.

In the absence of clear guidance to determine fair value, value in use etc., in the short term, it is likely that many entities will consult valuation experts in order to apply IAS – 36 and in longer term best practices in industry shall evolve for entities to follow.

*In future,  
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an impairment  
test.*

# Audit of Fair Value Accounting Estimates

\*CA. Karuna Bhansali

Recent years have seen major changes in financial reporting worldwide. While, various trends can be identified (such as the emergence of narrative reporting including ‘management commentary’), one of the significant change is convergence towards International Financial Reporting Standards (IFRS). In view of changing scenario in context of IFRS and valuation rules, Standard on Auditing (SA) 540 “Auditing Accounting Estimates, including Fair Value Accounting Estimates and Related Disclosures” have also been revised which provide guidelines about the responsibilities of an auditor regarding accounting estimates, including fair value accounting estimates and related disclosures in an audit of financial statements.

## Nature of Accounting Estimates

Accounting is a continuous process, which is based on certain assumptions, principles and concepts. To know the financial position at the end of the period or say profit or loss of the period, we have to make certain estimates in relation to some financial statement items, as they cannot be measured precisely. Those accounting estimates may be in form of method of depreciation or useful life for an asset, or may be as a provision for doubtful debts for debtors. These accounting estimates depend on the applicable financial reporting framework, degree of uncertainty and the financial item to be reported.

When there is an uncertainty regarding estimates like when estimates has to be made in relation to such kind of asset which is held for sale/disposal, or with reference to some complex financial instruments for which there is no active and open market or when there is an exchange of assets or liabilities transaction between independent parties, fair value method of accounting estimate should be used.

## What is Fair Value?

Definition of fair value may differ with reference to applicable financial reporting frameworks, or for different assets, liabilities or disclosures within a particular framework. The applicable financial reporting framework is defined as “The financial reporting framework adopted by management and, where appropriate, those charged with governance in the preparation and presentation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements, or that is required by law or regulation”.

As per Accounting Standard (AS) 30, “Financial Instruments: Recognition and Measurement” fair value is “the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm’s length transaction”.

So we can say that fair value is the amount for which an asset may be transferred or a debt may be settled, between parties who are mutually independent and who have a vested interest in completing the transaction. But certain specified adjustments or modifications to valuation information for a particular asset or liability should be done as per its financial reporting framework.

In addition, fair value hierarchy should be as per financial reporting framework, to distinguish inputs for use in arriving at fair values, ranging from those that involve clearly “observable inputs” based on quoted prices and active markets, and those “unobservable inputs” that involve an entity’s own judgments about assumptions that marketplace participants would use.

## Role of Financial Reporting Framework in Fair Value Estimates

Financial Reporting Framework plays vital role in relation to specific fair value measurements and

*\* The author is Assistant Director, ICAI.*

disclosures in financial statements. It not only prescribes measurement, presentation and disclosure requirements for certain information (in the financial statements or in notes to financial statements or presented as supplementary information) but also provides guidelines for specific method for determining fair value, for example, through the use of an independent appraisal or specified ways of using discounted cash flows.

### **Fair Value Estimates Risk Assessment and Related Activities**

The auditor shall obtain understanding of the entity and its environment like the nature of entity, its ownership and governance structure etc. including entity's internal control to perform the risk assessment procedure and related activities effectively.

The auditor should ensure that the requirements of applicable financial reporting frameworks are complied with. It should also be ensured that the areas containing the risk of material misstatements are identified and assessed.

Accounting estimates may be made on the basis of expert opinion or may be with the use of some model or may be by some other mode, the duty of an auditor to obtain an understanding of business in order to identify that how management identifies the transactions, events and conditions that may need the accounting estimates and how accounting estimate's methods, assumptions, use of expert opinion etc are decided.

There may be certain accounting estimate, made for prior period items, the auditor should review the outcome of those accounting estimates included in the prior period financial statements for the purpose of the current period.

### **Responses of an Auditor to the identified & Assessed Risk**

The auditor should also obtain written representation from the management with reference to significant assumptions of which management believes that by using those assumptions accounting estimates would be reasonable.

An auditor has to play a key role when the risk of material misstatement has been identified or assessed. For accounting estimates that give rise to

significant risks, auditor has to evaluate that how management has considered alternative assumptions or outcomes and why it has rejected them and whether the significant assumptions used by management are reasonable and complied with consistently.

The auditor should also review the judgments and decisions made by management. If the auditor is of the view that management has not adequately addressed the effects of estimation uncertainty, the auditor shall develop a range to evaluate the reasonableness of the accounting estimate.

### **Disclosures Related to Accounting Estimates**

Different financial reporting frameworks require or permit a variety of fair value measurements and disclosures in financial statements.

Sufficient appropriate audit evidence should be obtained by an auditor to ensure that the accounting estimate and their disclosure in the financial statements are properly reflected and accounting estimates that gives rise to significant risks, are also disclosed adequately.

Needless to say that the basis of the auditor's conclusion about the appropriateness and reasonableness of accounting estimates and their disclosure (which gives rise to significant risks) and indicators of possible management bias should sufficiently form part of auditor's working papers.

***I have Miles to Go.....***

***The task stands accomplished***

***Nay- it has just begun***

***It's not a question of what stands achieved***

***It's a question of what still remains to be done***

***And am I not a creature of Destiny***

***A mere instrument for "His purpose"***

***My assignment I see as one of duty***

***Fruits whereof I cannot and do not seek***

***With humility and full dedication***

***I salute my Institute-I adore my profession***

**(Source: Kapadia G.P : History of Accountancy Profession in India, ICAI, 1937)**

## Some burning issues in Service tax

\*V S Datey



**T**here is no dearth of controversies in service tax. Some live controversial issues are discussed in this Article.

### 1. Service tax on Renting of immovable property

Service tax on renting of immovable property was imposed w.e.f. 1-6-2007. The intention to tax renting itself was clear by the circulars issued after imposition of tax.

However, in *Home Solution Retail India Ltd. v. UOI* (2009) 20 STT 129 (Del HC DB), it was held that service *in relation to* renting of immovable property' is taxable (e.g. air conditioning of immovable property given on rent), but 'renting of immovable property' is not a taxable service.

The decision of Delhi High Court was not on the basis of constitutional invalidity. It was only on the ground that in renting, there is no 'value addition'.

On the basis of the judgment of Delhi High Court, many tenants had stopped paying service tax due to which landlords had come in a very difficult situation. Government lost no time in filing appeal, but decision of Supreme Court was not forthcoming.

Government made it clear its view that as per their interpretation of legislative intention, service tax is payable on renting of immovable property, by issuing Instruction No. 336/10/2009-TRU dated 15-7-2009.

Now, an amendment has been made in Finance Act, 2010, to provide explicitly that the activity of 'renting' itself is a taxable service. This change is being given retrospective effect from 1-6-2007.

It is clear that Government took action as early as possible. Really, Government had no option but to make amendment with retrospective effect.

**Further development** – Writ petition was filed against the retrospective amendment. In *Home Solutions Retails Ltd. v. UOI* [WP(C) 3339/2010 order dated 18-5-2010], stay has been granted by Hon. Delhi Court. The stay is only in respect of the applicants and not a general stay.

**Action by landlord** – It should be noted that statutory liability is on landlord. Liability of tenant is only contractual. Hence, it is safe to collect and pay service tax. It may be noted that if service tax is found to be payable later, it will have to be paid with interest @ 13%.

**If tenant is in dictating position and not in position to avail Cenvat credit** – If the tenant is not in position to avail Cenvat credit (and if he is in position to dictate terms to landlord), he can refuse to pay service tax (and let landlord suffer), since the tenant has no statutory liability to pay service tax or even interest.

**Demand beyond one year time barred** – If show cause notice was not issued so far, demand beyond one year will be time barred if assessee can establish *bona fide* belief.

### 2. What is export of service

#### Exported service is exempt from service tax.

Following conditions are common in respect of *all* taxable services, for treating the service as export of service. - (a) The service should be provided from India and used outside India [rule 3(2)(a) of Export of Service Rules] and (b) Payment for such service is received by the service provider in convertible foreign exchange [rule 3(2)(b) of Export of Service Rules existing upto 27-2-2010]. [The condition as clause (a) has been deleted w.e.f. 27-2-2010].

*\*The author is a noted writer and Consultant on Indirect Tax*

CBE&C, vide circular No. 111/05/2009-ST dated 24-2-2009 has clarified that 'used outside India' mean 'benefit should accrue outside India'. A service can be 'export' even if all relevant activities take place in India, so long as the benefit of these services accrue outside India.

Just as everyone thought that the issue has been settled, controversy and confusion has been created by Tribunal decision in *Microsoft Corpn v. CST* (2009) 22 STT 201 (CESTAT). In this case, the assessee was providing marketing support service in India to its holding company in USA and subsidiary in Singapore. The service was provided to customers of the holding company in USA and subsidiary in Singapore. A *prima facie* view was held that this is not export of service, and assessee was asked to make pre-deposit of Rs 70 crores out of demand of Rs 125 crores of tax plus Rs 125 crores as penalty – writ petition against the order has been dismissed – *Microsoft Corporation P Ltd. v. CST* (2009) 23 STT 400 (Del HC DB).

In this case, Microsoft Operation P Ltd., Singapore (MO, Singapore) entered into 'Market Development Agreement' with Microsoft Corporation (India) P Ltd. (assessee - Microsoft India for short). Both are subsidiaries of Microsoft Corporation, USA. Microsoft Singapore will supply Microsoft products to customers in India. Microsoft India is required to provide product support services and consulting services for Microsoft products. Microsoft India is also required to market Microsoft products supplied by MO, Singapore.

For various services provided by assessee (Microsoft India), payment will be made by MO, Singapore on basis of expenses incurred by assessee plus 10% for product support and consulting services and plus 15% in case of marketing of Microsoft products. Payment was obviously in freely convertible foreign currency.

Assessee claimed that the service is 'export of service' and exempt. Commissioner, in effect, held that the services are used in India and hence is not 'export of service'. This view was more or less upheld by Tribunal. There are some other issues in this case, which are not relevant for our discussions.

**Basic issue is who is user of service** – The basic issue for consideration is whether service of Microsoft India is 'used outside India'. Who is the user of service provided by Microsoft, India? The customers in India received products from

Microsoft, Singapore and not from Microsoft, India. Thus, their privity of contract was with Microsoft, Singapore. Indian customers did not make any payment to Microsoft, India. Payment for services was made by Microsoft, Singapore to Microsoft, India in foreign exchange based on cost plus markup.

**Classification of service** – In entire judgment of Tribunal, no effort was made to decide classification of service. The service should fall under Business Auxiliary Service [clause (vii)] i.e. provision of service on behalf of client. It should fall under rule 3(iii) of Export of Service Rules.

**Service is used outside India** – User of services of assessee (Microsoft, India) can be only Microsoft, Singapore and not any customer of Microsoft, Singapore situated in India. Thus, service is 'used outside India' as the user (Microsoft, Singapore) is situated outside India and he got benefit from the service outside India.

**Conclusion** – It can be argued that service is provided by Microsoft India to Microsoft, Singapore. The user and beneficiary of service provided by Microsoft India is Microsoft, Singapore who is situated outside India and does not have any office in India. Thus, the service is used outside India. It should qualify as 'export of service', more particularly because in reverse direction, it is treated as 'import of service' and is treated as taxable in India.

### 3. Software – goods or service?

Hamlet had said 'To be or not to be, that is the question'. Indian assesseees are saying 'Software is goods or service (or both), that is the question'.

In *Bharat Sanchar Nigam Ltd. v. UOI* (2006) 3 SCC 1 = 152 Taxman 135 = AIR 2006 SC 1383 = 3 STT 245 = 145 STC 91 = 3 VST 95 = 282 ITR 273 (SC 3 member bench), it has been held that both packaged and tailor made software are 'goods'.

Software falls in heading 8523 80 20 of Central Excise Tariff. However, all software, except canned software i.e. software that can be sold off the shelf, is 'exempt'. Duty on packaged software is 10% w.e.f. 27-2-2010, while there is no excise duty on tailor made i.e. customised software - Sr No. 27 of notification No. 6/2006-CE dated 1-3-2006 as amended w.e.f. 27-2-2010.

'Packaged software or canned software' means a software developed to meet the needs of variety of

users, and which is intended for sale or capable of being sold, off the shelf [*Explanation* to Notification No. 17/2010-CE dated 27-2-2010 and Sr No. 27 to Notification No. 6/2006-CE dated 1-3-2006].

**Whether both service tax and excise are payable on software?** – The issue is whether both service tax and CVD/excise duty are payable on software. Can a thing be goods and service at one and the same time?

**Single use packaged or canned software** – Manufacturer/importer should pay excise duty/CVD on entire value of consideration received from buyer and then no service tax is will be payable (Notification No. 2/2010-ST dated 27-2-2010 in respect of excise duty and Notification No. 17/2010-ST dated 27-2-2010 in respect of CVD on imports.

The term ‘single use’ has not been defined. If the software is permitted to be used on more than one computers, it can be termed as ‘multi-use’ (as the term used is ‘single use’ and not ‘single user’).

SSI units can avail exemption from excise duty but then they will be liable to pay service tax as the exemption under Notification No. 2/2010-ST is subject to condition that ‘appropriate duties of excise’ should have been paid .

**Other packaged or canned software** – In case of other packaged software (i.e. multi-use), excise duty will be payable on consideration paid or payable for transfer of right to use such software [Notification No. 17/2010-CE dated 27-2-2010]. In case of imports, corresponding CVD will be payable [Notification No. 31/2010-Cus dated 27-2-2010]. On remaining amount, service tax will be payable.

It may be noted that in case of branded (tailor made) software, there is no ‘sale’ of software as such as entire property in software is never passed on to buyer. Only right to use is transferred (some times for a limited period, which has to be renewed by paying further amount). There will be ‘sale’ of software only if source code and entire property in software is transferred to buyer.

If the manufacturer/service provider charges some amount over and above the consideration received for transfer of right to use (may be for installation, customisation etc.), service tax will be payable on such amount. Service tax cannot be demanded on amount on which excise duty has been paid, since assessee can claim deduction of value of material under Notification No. 12/2003-ST.

SSI units can avail exemption of excise duty but they will be exposed to liability of service tax, though they can argue that value of service is Nil.

**Renewal of license of packaged software** – Sometimes, the license to use packaged software is for limited period (usually one year). The license is renewed on payment of renewal fee by giving password. Thus, ‘packaged software’ is not sold. In such cases, in my view, service tax will become payable, since packaged software ‘packed with document providing right to use’ is not given.

**Customised software** – Customised software is subject to service tax but assessee can claim deduction of value of material under Notification No. 12/2003-ST dated 20-6-2003.

**4. Valuation in case of construction service**

Any person providing taxable service of commercial or industrial construction or construction of complex can opt to pay service tax on 33% of gross amount charged - Notification No. 1/2006-ST dated 1-3-2006. The partial exemption is available only if the gross amount charged includes value of goods and materials **supplied or provided or used** by provider of the commercial or industrial construction of service for providing such service (*Explanation* to Notification No. 1/2006-ST). *However, value of land is not required to be added as it is neither goods nor material.*

The dispute is whether the value of material supplied by customer to service provider is required to be added while calculating ‘gross amount charged’.

Suppose the contract for construction is for Rs. 8,00,000 which includes job charges plus material which is to be supplied by contractor. The customer has agreed to supply steel to contractor, the value of which is Rs. 2,00,000. Its value is not considered in quotation given by contractor. The contractor can opt to pay duty @ 33% on total value. The issue is whether service tax is payable on value equal to 33% of Rs 8 lakhs or Rs 10 lakhs.

In *Jaihind Projects v. CST* (Appeal No. ST/21 & 42/2008 decided on 5-1-2010 - CESTAT), it has been held that value of material supplied by customer to service provider (contractor) is required to be added [i.e. 33% of Rs 10 lakhs] (This decision seems to be correct).

However, in *CEMEX Engineers v. CST* (2009) 23 STT 389 (CESTAT), it has been held that value of material supplied by customer to contractor is not required to be added.

## Standards on Auditing

The three new Standards on Auditing (SAs) under the series of 800-899 deals with Specialized Areas issued under the Clarity Project, which are effective for audits of financial statements for periods beginning on or after April 1, 2011 are.

S.No.	SA	Title of Standard on Auditing
1	SA 800	Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks
2	SA 805	Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement
3	SA 810	Engagements to Report on Summary Financial Statement

An introduction to SA 800.

Standard on Auditing (SA) 800, “Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks”

SA 800 is a new Standard on Auditing, which deals with special considerations in applying SAs to audits of Special Purpose Financial Statements and deals with a complete set of Financial Statements. This SA should be read in the context of the “Preface to the Standards of Quality Control, Auditing, Review, Other Assurance and Related Services” which sets out the authority of SAs and SA 200(Revised) “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing”.

It defines the terms ‘Special purpose framework’ and ‘Special purpose financial statements’. It also deals with the special considerations relating to engagement acceptance, planning and performing engagement and forming opinion and reporting aspects. This SA is written in the context of a complete set of financial statements prepared in accordance with a special framework. This SA does not override the requirement of the other SAs; nor does it purport to deal with all special considerations that may be relevant in the circumstances of the engagement.

For details visit: [http://www.icai.org/post.html?post\\_id=450&c\\_id=141](http://www.icai.org/post.html?post_id=450&c_id=141)

## International Financial Reporting Standards

### IFRS Taxonomy 2010 released by IASC Foundation

The International Accounting Standards Committee (IASC) Foundation has recently released the IFRS Taxonomy 2010. A taxonomy defines business concepts (such as *assets* and *liabilities*), and the relationship between these concepts. The IFRS Taxonomy is the XBRL (eXtensible Business Reporting Language) representation of International Financial Reporting Standards (IFRSs) as issued at January 1, 2010, including International Accounting Standards (IASs), Interpretations, and the IFRS for Small and Medium-sized Entities (SMEs), issued by the IASB. IFRS Taxonomy includes all IFRSs which contain disclosure requirements. IFRS Taxonomy seeks to address the demand for an electronic standard to transmit IFRS financial information. The 2010 taxonomy contains significant architectural improvements when compared with the 2009 version which include an extended use of axes (dimensions) in the taxonomy. To accompany the

release of this taxonomy, the IASC Foundation is undertaking a consultation with companies using IFRS and filing with the US Securities and Exchange Commission to establish that the IFRS Taxonomy is practical for filers and the users of filed XBRL content.

(Source: <http://www.iasb.org/News/>)

### 2008-2010 Cycle of Annual Improvements to IFRS The International Accounting Standards Board (IASB) has recently issued *Improvements to IFRSs - a collection of amendments to seven International Financial Reporting Standards (IFRSs) - as its latest set of annual improvements.*

By presenting the amendments in a single document rather than a series of piecemeal changes, the IASB aims to ease the burden of change for all concerned. Unless otherwise specified, the amendments are effective for annual periods beginning on or after 1 January 2011, with earlier application permitted.

(Source: <http://www.iasb.org/News/>)

## Income Tax

**Circulars/ Notifications issued by the CBDT during the period 01.05.2010 to 31.05.2010**

### I. CIRCULARS

**Circular No. 4/2010 dated 18.5.2010**

**Clarification regarding definition of a new infrastructure facility for the purpose of Section 80-IA(4)**

The CBDT has, vide this Circular, clarified that widening of an existing road by constructing additional lanes as a part of a highway project by an undertaking would be regarded as a new infrastructure facility for the purpose of section 80-IA(4)(i). However, simply relaying of an existing road would not be classifiable as a new infrastructure facility for this purpose.

The complete text of the above-mentioned circular can be downloaded from the following link:

[http://law.incometaxindia.gov.in/DIT/File\\_opener.aspx?page=CIR&schT=&csId=b5ecf6f8-c111-48ab-ac3b-69f737bd1296&sch=&title=Taxmann - Direct Tax Laws](http://law.incometaxindia.gov.in/DIT/File_opener.aspx?page=CIR&schT=&csId=b5ecf6f8-c111-48ab-ac3b-69f737bd1296&sch=&title=Taxmann - Direct Tax Laws)

### II. NOTIFICATIONS

- Notification No. 33/2010 dated 11.5.2010  
New ITR's - ITR 2, ITR 3, ITR 4, ITR 5, ITR 6 & ITR 7 for A.Y. 2010-11

In exercise of the powers conferred by section 295 of the Income-tax Act, 1961, the CBDT has,

through the Income-tax (Fourth Amendment) Rules, 2010 notified the new ITR Forms – namely ITR 2, ITR 3, ITR 4, ITR 5, ITR 6, ITR 7 & ITR V for the assessment year 2010-11.

**The complete text of the above-mentioned notification can be downloaded from the following link:**

[http://law.incometaxindia.gov.in/DIT/File\\_opener.aspx?page=NOTF&schT=&csId=60aa4b61-20a4-44aa-85a7-88b8ac51b021&NiN=&yr=ALL&sec=&sch=&title=Taxmann - Direct Tax Laws](http://law.incometaxindia.gov.in/DIT/File_opener.aspx?page=NOTF&schT=&csId=60aa4b61-20a4-44aa-85a7-88b8ac51b021&NiN=&yr=ALL&sec=&sch=&title=Taxmann - Direct Tax Laws)

Notification No. 41/2010 dated 31-05-2010

**Amendment in Rules relating to TDS/TCS**

In exercise of the powers conferred by section 295 of the Income-tax Act, 1961, the CBDT has, through the Income-tax (6<sup>th</sup> Amendment) Rules, 2010 omitted Rule 37A and substituted Rules 30, 31, 31A, 31AA, 37CA, 37D in the Income tax Rules, 1962. Further, Form Nos. 16, 16A, 27D were also substituted and new Form No. 24G has been inserted.

**The complete text of the above-mentioned notification can be downloaded from the following link:**

[http://law.incometaxindia.gov.in/DIT/File\\_opener.aspx?page=NOTF&schT=&csId=35524106-1528-4ba1-b153-81ea0f165a41&NiN=&yr=ALL&sec=&sch=&title=Taxmann - Direct Tax Laws](http://law.incometaxindia.gov.in/DIT/File_opener.aspx?page=NOTF&schT=&csId=35524106-1528-4ba1-b153-81ea0f165a41&NiN=&yr=ALL&sec=&sch=&title=Taxmann - Direct Tax Laws)

## Indirect Tax

- Notification No. 20/2010 CE (NT) dated 18.05.2010 and Notification No. 21/2010 CE (NT) dated 18.05.2010**

With effect from 01.06.2010,

- quarterly return of CENVATABLE invoices submitted by the first/second stage dealer under rule 9(8) of the CENVAT Credit Rules, 2004 shall be filed electronically irrespective of the amount of CENVAT credit taken by them or passed on by them in a year and
- the following statements/returns shall be filed electronically if the manufacturer of final products has paid total excise duty of Rs.10 lakh or more including the amount of duty paid by utilization of CENVAT credit in the preceding financial year:
  - Annual Financial Information Statement - **ER-4**
  - Monthly return by EOU - **ER-2**
  - Information relating to principal inputs - **ER-5**
  - Monthly return of receipt and consumption of each of principal inputs - **ER-6**

- Circular No. 923/12/ 2010-CX dated 19.05.2010 Issue**

Whether cost of return fare of vehicles is to be included in the assessable value of the excisable goods?

### Clarification

It is clarified that cost of return fare of vehicles is not required to be added for determining value of the excisable goods.

- Circular No. 922/12/ 2010-CX dated 18.05.2010**

Power and the monetary limits of adjudication of certain Central Excise Officers have been revised as follows:-

#### **Central Excise Officers Power of adjudication (Amount of duty involved)**

Superintendents Upto Rs. 1 Lakh (excluding cases involving determination of rate of duty or valuation and cases involving extended period of limitation)

Deputy/Assistant Commissioners Upto Rs. 5 Lakh (except the cases where Superintendents are empowered to adjudicate).

- Circular No. 123/5/2010-TRU dated 24.05.2010**

A clarification has been issued on the applicability of service tax on laying of cables under or alongside roads and similar activities.

For complete text of the above notifications and circulars, visit: <http://www.cbec.gov.in/>

## Business & Corporate Laws

### (i) The Payment of Gratuity Act, 1972

The present limit of gratuity to be paid has been increased from the present level of Rs. 3.5 Lacs to Rs. 10 Lacs through the Notification S.O. 1217(E) dated 24<sup>th</sup> May, 2010. For further details refer [www.labour.nic.in](http://www.labour.nic.in)

### (ii) The Companies Act, 1956

The Ministry of Corporate Affairs (MCA) has introduced two schemes w.e.f. 30<sup>th</sup> May, 2010 which would enable the defaulting companies to make their default good by filing belated documents and to become a regular compliant in future and give an opportunity to the defunct companies, for getting their names strike off from the Register of Companies (ROC). The two schemes are as follows:

#### Company Law Settlement Scheme, 2010

The Ministry, in exercise of the powers under Section 611(2) and 637B (b) of the Companies Act, 1956 has introduced the "Company Law Settlement Scheme, 2010," vide its General Circular No. 1 / 2010 dated May 26, 2010 which will close on **31<sup>st</sup> August, 2010**. According to this scheme, the companies shall first file its documents to increase their authorized capital to the minimum capital required as per Section 3 of the Companies Act, 1956 and then file belated documents, which have not been filed within the prescribed period at cost reduced by 75% on the additional fee payment.

#### Easy Exit Scheme, 2010

With a view to provide an easy exit to the Companies which are desirous of getting the name struck off from the records of the ROC or are **defunct companies** i.e. such companies which are inoperative since incorporation or have commenced business but are inoperative later on and not filing their due documents timely with the Registrar of Companies, the Ministry has come out with an Easy Exit Scheme, 2010 vide its General Circular No. 2 /2010 dated May 26, 2010 which will also close on **31<sup>st</sup> August, 2010**. According to

this scheme, any defunct company may make an application in form EES 2010 to struck off its name from register of members.

For further details, refer [www.mca.gov.in](http://www.mca.gov.in)

### (iii) Securities Contracts Regulation Act, 1956

The Ministry of Finance through Press Release F.No.5/35/2006-CM dated 4<sup>th</sup> June, 2010 has notified Securities Contracts (Regulation) Amendment Rules, 2010 pursuant to which all listed companies are now required to offer and maintain a minimum public shareholding of 25%. This amendment is going to bring huge supply of stocks in the market. For further details refer [www.finmin.nic.in](http://www.finmin.nic.in)

### (iv) Foreign Exchange Management Act, 1999

(a) The Reserve Bank of India through Notification no. G.S.R. 382(E) dated 5<sup>th</sup> May, 2010 has notified Foreign Exchange Management (Current Account Transactions) (Amendment) Rules, 2010 by omitting item number 8 of Schedule II to the Foreign Exchange Management (Current Account Transactions) Rules, 2000. As a result of this, now prior approval of the Ministry of Commerce and Industry, Government of India, is not required for drawing foreign exchange for remittances under technical collaboration agreements where payment of royalty exceeds 5% on local sales and 8% on exports and lump-sum payment exceeds USD 2 million.

(b) The Reserve Bank of India through Circular no. 49 dated 4<sup>th</sup> May, 2010 has revised the pricing guidelines for transferring **equity shares, compulsorily convertible preference shares and compulsorily convertible debentures by way of Sale from a resident to a non-resident and vice versa**.

For further details, refer [www.rbi.org.in](http://www.rbi.org.in)

**The above amendments are not applicable for November 2010 examinations.**

## Campus Placement Programme for selection of Articled Assistants by CA Firms – August, 2010

Board of Studies of the Institute proposes to introduce optional Campus Placement Scheme for selection of Articled Assistants by CA firms at various centres all over India. The scheme has been evolved to provide an opportunity to the firms of Chartered Accountants having vacancies for articled assistants to interact with the candidates who have passed Group I of IPCC Examination and are eligible for undergoing articled training, for selecting them as articled assistants in their firms.

The first programme would be organized in August, 2010 (preferably on Saturday and Sunday) at the offices of the Regional Councils and Branches of the Institute, depending upon the feedback to be received from both CA firms and eligible candidates. Both CA firms as well as eligible candidates who would like to participate in the programme shall have to register themselves. Further details will be hosted on ICAI website [www.icai.org](http://www.icai.org) shortly. The entire process would be done online through a designated portal.

## Income Tax

- 1. In a case where the partnership deed does not specify the remuneration payable to each individual working partner but lays down the manner of fixing the remuneration, would the assessee-firm be entitled to deduction in respect of remuneration paid to partners?**

***CIT v. Anil Hardware Store (2010) 323 ITR 0368 (HP)***

The partnership deed of the assessee firm provided that in case the book profits of the firm are up to Rs.75,000, then the partners would be entitled to remuneration up to Rs.50,000 or 90% of the book profits, whichever is more. In respect of the next Rs.75,000, it is 60% and for the balance book profits, it is 40%. Thereafter, it was further clarified that the book profits shall be computed as defined in section 40(b) of the Income-tax Act, 1961, or any other provision of law as may be applicable for the assessment of the partnership firm. It was also provided that in case there was any loss in a particular year, the partners would not be entitled to any remuneration. Clause 7 of the partnership deed laid down that the remuneration payable to the partners should be credited to the respective accounts at the time of closing the accounting year and clause 5 stated that the partners shall be entitled to equal remuneration.

The High Court held that the manner of fixing the remuneration of the partners had been specified in the partnership deed. In a given year, the partners may decide to invest certain amounts of the profits into other venture and receive less remuneration than that which is permissible under the partnership deed, but there is nothing which debars them from claiming the maximum amount of remuneration payable in terms of the partnership deed. The method of remuneration having been laid down, the assessee-firm is entitled to deduct the remuneration paid to the partners under section 40(b)(v) of the Income-tax Act.

**Note:**

- (1) *Payment of remuneration to working partners is allowed as deduction if it is authorized by*

*the partnership deed and is subject to the overall ceiling limits specified in section 40(b)(v). The limits for partners' remuneration under section 40(b)(v) has revised upwards w.e.f. A.Y.2010-11 and the differential limits for partners' remuneration paid by professional firms and non-professional firms have been removed. On the first Rs.3 lakh of book profit or in case of loss, the limit would be the higher of Rs.1,50,000 or 90% of book profit and on the balance of book profit, the limit would be 60%.*

- (2) *The CBDT had, vide Circular No. 739 dated 25.3.1996, clarified that no deduction under section 40(b)(v) will be admissible unless the partnership deed either specifies the amount of remuneration payable to each individual working partner or lays down the manner of quantifying such remuneration.*

*In this case, since the partnership deed lays down the manner of quantifying such remuneration, the same would be allowed as deduction subject to the limits specified in section 40(b)(v).*

- 2. Does the Central Board of Direct Taxes (CBDT) have the power under section 119(2)(b) to condone the delay in filing return of income?**

***Lodhi Property Company Ltd. v. Under Secretary, (ITA-II), Department of Revenue (2010) 323 ITR 0441 (Del.)***

The assessee filed his return of income (which contained a claim for carry forward of losses) a day after the due date. The delay of one day in filing the return of income was due to the fact that the assessee had not reached the Central Revenue Building on time because he was sent from one room to the other and by the time he reached the room where his return was to be accepted, it was already 6 p.m. and he was told that the return would not be accepted because the counter had been closed. These circumstances were recorded in the letter along with the return of income delivered to the office of the Deputy Commissioner of Income-tax on the very next day. Later on, the CBDT, by a non-speaking order, rejected

the request of the assessee for condonation of delay in filing the return of income under section 119.

The issue under consideration is whether the CBDT has the power under section 119(2)(b) to condone the delay in filing return of income.

The High Court held that the Board has the power to condone the delay in case of a return which was filed late and where a claim for carry forward of losses was made. The delay was only one day and the assessee had shown sufficient reason for the delay of one day in filing the return of income. If the delay was not condoned, it would cause genuine hardship to the petitioner.

Therefore, the Court held that the delay of one day in filing of the return was to be condoned.

**Note:** Section 119(2)(b) empowers the CBDT to authorise any income tax authority to admit an application or claim for any exemption, deduction, refund or **any other relief under the Act** after the expiry of the period specified under the Act, to avoid genuine hardship in any case or class of cases. The claim for carry forward of loss (in case of a loss return) is relatable to a claim arising under the category of any other relief available under the Act. Therefore, the CBDT has the power to condone the delay in filing of such loss return due to genuine reasons.

## Indirect Tax

### 1. Whether the theoretical possibility of product being sold is sufficient to establish the marketability of a product?

***Bata India Ltd. v. CCE 2010 (252) ELT 492 (SC)***

The Apex Court observed that marketability is essentially a question of fact to be decided on the facts of each case and there can be no generalization. The test of marketability is that the product which is made liable to duty must be marketable in the condition in which it emerges. The question is not whether there is a hypothetical possibility of a purchase and sale of the commodity, but whether there is sufficient proof that the product is commercially known. The mere theoretical possibility of the product being sold is not sufficient but there should be commercial capability of being sold. Theory and practice will not go together when one examine the marketability of a product.

The Supreme Court further ruled that the burden to show that the product is marketed or capable of being bought or sold is entirely on the Revenue. Revenue, in the given case, had not produced any material before the Tribunal to show that the product was either been marketed or capable of being marketed, but expressed its opinion unsupported by any relevant materials.

**Note :** The above judgment is in conformity with the explanation to section 2(d) of the Central Excise Act, 1944 inserted by the Finance Act, 2008.

### 2. Whether the machine which is not assimilated in permanent structure would be considered to be moveable so as to be dutiable under the Central Excise Act?

***CCE v. Solid & Correct Engineering Works and Ors 2010 (252) ELT 481 (SC)***

**The assessee was engaged in the manufacture of asphalt batch mix and drum mix/hot mix plant by assembling and installing its parts and components. The Court observed that as per the assessee, the machine is fixed by nuts and bolts to a foundation not because the intention was to permanently attach it to the earth, but because a foundation was necessary to provide a wobble free operation to the machine.**

The Court opined that an attachment where the necessary intent of making the same permanent is absent cannot constitute permanent fixing, embedding or attachment in the sense that would make the machine a part and parcel of the earth permanently.

Hence, the Supreme Court held that the plants in question were not immovable property so as to be immune from the levy of excise duty. Consequently, duty would be levied on them.

## Easy Exit Scheme- 2010

\* Megha Goel

**A** Certificate of incorporation issued to a company is a conclusive proof of evidence that all requirements under the provisions of the Companies Act, 1956 and matters precedent and incidental thereto have been complied with and therefore once certificate is issued it cannot be revoked. Though, a company once formed has a perpetual succession, it is to be remembered that a company is not created by the Act, rather it comes into existence in accordance with the various provisions of the Act and therefore it is the duty of the company to see that in order remain as a legal persona, it should not only be formed but continue to function uninterrupted, lest it has to come with the realm of the consequences that have been prescribed under various provisions of the Act. To illustrate, a public company which fails to call for a statutory meeting under section 165 is liable to be wound up. Similarly a company though formed and registered under the Act has been inoperative or commenced business under section 145 and became inoperative thereafter or not filing returns regularly with the Registrar are companies which can be categorised as 'defunct' (not functioning) and therefore they are liable to be struck from the Register of Companies. Even failure to raise the threshold limit of minimum capital entails the company's name to be struck off from the Register by the ROC and he is only required to publish in the Official Gazette notice that the name has been struck. Section 560 of Act prescribes the procedure for striking off the name of the company and in order to encourage such of those companies to follow an easy procedure by way of a scheme under the Act, the MCA has recently come out with a scheme known as 'Easy Exit Scheme, 2010 which will be in operation from 30<sup>th</sup> May, 2010 and remain in force up to 31<sup>st</sup> August, 2010. A similar scheme, Fast Track Section 560 Scheme, Simplified Exit Scheme, were introduced during the years 2000 and 2003 respectively.

### Applicability and Non-applicability

The EES, 2010 is applicable to any defunct company which has active status on the portal of the MCA and also includes a Government Company, NBFC, Collective Investment Management Company. It is not applicable for listed companies, Section 25 companies, vanishing companies, companies under inspection or investigation, companies facing prosecution and pending before the ROC, CLB, Court, and other authorities under various other statutes like income tax/sales tax/excise/banks/financial institutions etc.

### Procedure

1. Application to be made in Form EES 2010 electronically by any defunct company desirous of getting its name striking from the Register.
2. Form EES 2010 to be duly signed by the director or Manager or Secretary. If not digitally signed, a physical copy shall be signed manually by a director authorised by the Board and attached with the application Form filed electronically.
3. The Form in all cases is certified by a CA/CS/Cost accountant in Whole time practice.
4. All pending litigations in which the company is involved should be disclosed and supported by way of an Affidavit.
5. The Affidavit should state that the company has not carried on any business since incorporation or that it did some business for a specified period and thereafter discontinued its operations and no business was carried on after 1<sup>st</sup> April, 2008.
6. The Form should further be accompanied by an indemnity bond duly notarised and given by every director individually that any losses, claim and liabilities will be met in full by every director individually or collectively even after the name is struck off.
7. The company should also file a Statement of Account ( Sources and Applications) prepared as on date not prior to more than one month preceding the date of filing of application and duly certified by a statutory auditor or CA in whole time practice.
8. The ROC shall after examining the application, inviting objections from stakeholders, giving 30 days of notice strike off the name from the Register and the company will be dissolved.

### Introspection

Striking off the company's name by the ROC does not mean that the company is legally absolved from any further course of action that may arise in future and it does not materially affect the rights of creditors to enforce their claims against every director apply to the court for winding-up and apply to the Court for restoration of the name of the company within 20 years from the date the name is struck off.

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*\*The author is faculty, ICAI*

### Solution to the Case Study on Somgeets Pvt.Ltd. published in the May 2010 issue

#### Answer to questions 1 & 2

#### Solutions (All computations in Rs'000)

Years	0	1	2	3	4	5	At Termination
Revenue		2500	2500	2500	2500	2500	
Cash Costs		1750	1820	1893	1969	2047	
Cash Margin		750	680	607	531	453	
Depreciation		210	210	210	210	210	
Taxable Profits		540	470	397	321	243	
Tax		189	165	139	112	85	
PAT		351	305	258	209	158	
Op Cash Flow		561	515	468	419	368	
Investments							
W/C	(425)						
Equip	(800)						
Building	(500)						
Investment Recovery							
W/C							425
Equip & Building							88
Net Cash Flow	(1725)	561	515	468	419	368	513

#### Financial Computations (without land value)

1. NPV = Rs 137.86
2. IRR = 18.25%
3. Payback = 3.43 years

The land which belongs to the company and is lying vacant may be used for the project now and sold once the project is over. However, the land appreciation at 6.5% after tax, is less than the cost of capital of 15%. This would suggest that the project need not be undertaken and Somgeets would be financially better off selling the land immediately rather completing the project and then effecting the sale.

In such a scenario, inclusion of Rs 3, 00,000 for Land at time zero and post tax recovery of Rs 3, 42,000 after five years shall be relevant.

Present value of Rs 3, 42,000 in 2005	=	Rs 1, 70,000
Revised NPV	=	Rs 7.84
Revised IRR	=	15.16%
Revised Payback	=	4.84 years

- Ans 3) The proposal is a good deal for the Railways specially because of the fixed price quoted for 5 years. However, the Railways may find an IRR of over 15 % to be too high. In case such appears to be the case, management of Somgeets shall be advised to incorporate some amount of overheads in the financial analysis (say 5% of the sales) which they shall not find difficult to justify. In case of such an inclusion the NPV becomes negative and the IRR goes down below 10%.
- Ans 4) The proposal is a good deal for Somgeets Pvt Ltd as can be seen from the financial computations.

## B S R & Co.



We are looking for article students to join the Audit practice

### Location:

Mumbai/Delhi/Bangalore/Chennai/Pune/Hyderabad/Kochi/Kolkata/Chandigarh

### The Individual:

To be part of the team, the individual

- Should be from PEII or the Integrated Professional Competence Course (IPCC)
- Should have passed Group1 of IPCC or both groups of PEII
- Have strong soft skills like inter personal skills, team skills, communication skills both verbal and written

### Selection Process:

Candidates should expect minimum 3 rounds of personal interviews to assess clarity on concepts and communication skills. Interested candidates may please send in their updated CVs to [recruitments0910@gmail.com](mailto:recruitments0910@gmail.com)

## National Convention for CA Students

CA – A Vision Towards Conquering the World

Organized by: Board of Studies

Hosted by: EIRC of the ICAI & EICASA of the ICAI

SATURDAY, AUGUST 28, & SUNDAY, AUGUST 29, 2010.

Venue: Calcutta University – Centenary Hall, Kolkata

### Technical Sessions

#### Developments in Financial Reporting.

- Corporate Social Responsibility and Industrial Hazards
- Human Resource Accounting
- Inflation Adjustment

#### Auditing & Assurance.

- Auditing in Information Technology Environment
- SA 315 AND SA 330
- Audit Evidence and Documentation

#### Special Sessions

- Expectation of corporate world and newly qualified Chartered Accountants.
- Practical Training – Soul of CA Profession.
- Stress management.

**Participate as Paper Writer:** Students are invited to contribute papers for various technical sessions. **Students may submit a paper by e-mail to [erobos@icai.in](mailto:erobos@icai.in) & [sbardhan@icai.in](mailto:sbardhan@icai.in).**

**Registration fee:** Rs.550 per student. Early bird discount of Rs.50 up to 13/8/2010. Outstation delegates may pay Rs.150 extra per day for accommodation and food.

**Outstation delegates are requested to confirm their participation latest by 31<sup>st</sup> July 2010** for accommodation arrangement. Demand Draft to be drawn in favour of “Institute Chartered Accountants of India, EIRC”, payable in ‘Kolkata’.

**Contact: Convention Co-ordinator, National Convention for CA Students at Kolkata, EIRC of the ICAI, 7, Anandilal Poddar Sarani (Russell Street), Kolkata, 700 071, Phone: 033-39893989/3021-1120 to 23, Fax; 033-30211145/46; [ero@icai.org](mailto:ero@icai.org)**

**For complete details please visit <http://www.eircicai.org/>**

#### Direct and Indirect Taxation

- GST – Emerging trends.
- Tax Implications on Business Restructuring
- Revised Direct Tax Code

#### Law & Information Technology - Some Aspects

- Limited Liability Partnership
- SAP and ERP Implementation
- Role of Competition Act and Consumer Protection Act

## Discontinuance of Professional Education – II Course

Students registered for the Professional Education – II Course (PE-II) are hereby informed that the said course has been discontinued by the Institute of Chartered Accountants of India with the culmination of the May, 2010 examination.

Those students of PE-II course who have not yet/ are not able to clear the PE-II examination held in May, 2010 are advised to register themselves

for the Integrated Professional Competence Course (IPCC) by following the prescribed procedure for conversion from PE-II course to IPCC course. Detailed formalities to be completed in this regard can be obtained from the respective Decentralised Offices where the PE-II Course students are registered.

**Director, Board of Studies**

## Discontinuance of CA Final Examination under the old syllabus.

Students are hereby informed that the CA Final (Old) Course shall be discontinued with the holding of the November 2010 examination. In other words, November 2010 examination will be

the last attempt available to Final (Old) students and no further extension will be granted under any circumstances.

**Director, Board of Studies**

## Online Examination Application Form

In order to reduce the time taken in processing the OMR application forms and also to ensure accuracy in the data pertaining to Name, Registration No., Group/Centre/Medium opted, it has been decided to make the filling of Examination Application Forms **Online** as the only mode of application for various CA examinations with effect from May, 2011. The OMR format of exam application form will be discontinued effective from May, 2011 examinations. In other words from May, 2011 onwards application forms are required to be filled compulsorily and online. However for November, 2010 CA examinations submission of hard copies of the examination application forms will continue to be an option.

**As an incentive for the candidates filling the Online CA examination application forms, the cost of application form of Rs. 100 will be waived off (which is used to be recovered from the candidates submitting the online application forms).**

We request the students of the CA Course to utilize this incentive and submit their examination application forms for November, 2010 only through **Online** mode. However if it is not at all possible for them to submit the application forms online, they can continue to utilize the paper-pencil mode of application form (this option is available only for the November, 2010).

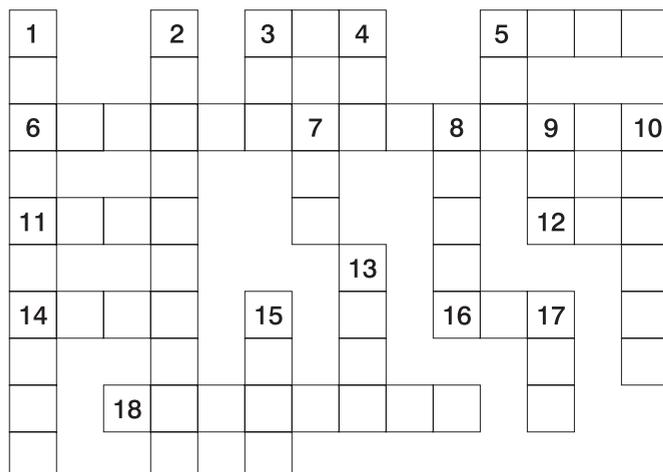
**(G. Somasekhar)**

Addl. Secretary (Exams.)

## Online Registration

The Northern India Regional Council (NIRC) of the ICAI has started **Online Registration, Selection of Batch, Venue and Schedule for General Management Communication Skills Course (GMCS) and Orientation Programme** in order to provide better services to the Students of the Institute. The students can access this through

the website [www.nirc-icai.org](http://www.nirc-icai.org) then select '**online Orientation**' or '**online GMCS**' as the case may be. Already registered Candidates till date can proceed through the icon '**Already Registered**' and those who wish to register afresh can proceed through the icon '**New Registration**'.



**CROSSWORD**
**ACROSS**

3. An instrument used for relieving international tax grievances, including double taxation. (3)
5. This was replaced by WTO in 1995 (4)
6. Guidance Notes are -----  
----in nature. (14)
11. ----- provides for life insurance where the policy value at any time varies according to the value of the underlying assets. (4)
12. A unique number that will be quoted on each and every income-tax related communication. (3)
14. One of the oldest Indian fertilizer companies. (4)
16. The provisions of section 194J are attracted in respect of payments made by a ..... on behalf of insurance companies to hospitals for settlement of medical/insurance claims. (3)
18. A term for foreign bonds in the United Kingdom. (8)

**DOWN**

1. If the employer gives a gift voucher of Rs.10, 000 to an employee, it would be considered as a ..... in the hands of the employee. (10)
2. In case of rights issue, ----- is not issued. (10)
3. Term used to record a change in the value of an asset to reflect its current fair market value on a daily basis. (3)
4. It is compulsory to quote ----- on return of income. (3)
5. A new indirect tax proposed to be introduced. (3)
7. The cash flows of project less a capital charge that reflects the opportunity cost of the capital invested, as well as any capital consumed. (3)
8. Advance payment of tax is an -----  
----. (5)
9. Describes a coupon bond that is issued at a discount. (3)
10. A term for foreign bonds in the United States. (5)
13. Which Inventory valuation method best matches the cost of goods sold with current replacement cost? (4)
15. By which authority Company Law Board is proposed to be replaced? (4)
17. This cost curve never touches the X-axis.