

INDORE BRANCH OF CIRC OF ICAI



NEWSLETTER

April, 2023 • Price ₹ 20



MANAGING COMMITTEE
2023-2024

Dear Members,

I am incredibly grateful for the trust and belief that all the members & MCM have bestowed upon me. Your unwavering support and confidence in my abilities mean so much to me, and I feel

honored to be part of profession. Your trust inspires me to do my best and to strive for excellence in all that I do. It's important to acknowledge the effort and time that Past chairman & MCM has put into their work in last year we you value their contributions and are grateful for the profession.

Leadership is not about being in control, but rather about empowering others and fostering collaboration. Ultimately, working together towards the betterment and brand building of a profession requires a collective effort and a willingness to collaborate and share knowledge, ideas, and resources. By doing so, we can help to drive growth, innovation, and success within our respective fields. I request all members to contribute their ideas and perspectives, and make an effort to create an inclusive and supportive environment.

I request our members to Promoting the benefits and value of your profession can help to raise awareness and build a strong brand "Brand CA" that attracts new talent, clients, and opportunities. No country or institution is perfect; it has to be made perfect, it can be made perfect only by working together. All of you are the soldiers of Branch ICAI & branch ICAI and your actions will create our brand image.

Indore branch is taking some new initiative towards the our nature Go Green :

No more Flower bouquet in seminar to be presented to speaker & guest instead we gift a plant to speaker and it will be plant it in Garden maintain by ICAI Indore.

No more plastic bottles will be used in indore branch instead we will use Copper, Glass & Steel bottles in branch.

Contribution to CABF fund : I appeal to all our Hon'ble Members to contribute generously making voluntary contribution towards The Chartered Accountants' Benevolent Fund (CABF). Remember that even a small donation can make a difference, and it's a meaningful way to celebrate your birthday by giving back to others.

We talked to our speaker and gave an option of contribution to CABF equal to the cost of the memento in lieu of the speaker's memento.

Link for contribution :<https://cabf.icai.org/voluntaryMember>

Finally, don't forget to take care of yourself as well. Being part of a Nobel profession can be demanding and time-consuming, so be sure to set realistic expectations for yourself and prioritize your mental and physical well-being.

Remember Success is the product of daily habits – not once in a lifetime transformation. – James Clear

Chairman's Communique



Yours truly,
CA Mausam Rathi
Chairman-Indore Branch of ICAI

From the Desk of Secretary



Dear Members, I am truly honoured by the trust instilled in me by the Central Council Members, Regional Council Members and Managing Committee Members. At the outset in my very first communiqué as Secretary, I would like to mention that we have derived the strength to challenge our self and perform better at each stage from our glorious past.

I am excited to work in team and will try to do best to add more gems to the crown of our Indore Branch of CIRC of ICAI. I wish to extend all the very best and success to CA. Mausam Rathi as he takes up the office of Chairman of Indore Branch of CIRC of ICAI and those members who are holding officer bearer positions for the session 2023 – 2024. During this time, we at branch have always tried to bring fruitful learning sessions with eminent speakers to foster the learning zeal of our members. With the passage of time, we at branch would now like to bring more and more interactive events with physical presence for our members.

We are hopeful for new month, numerous events has been scheduled this month by branch to discuss like Finalization of Books , Audit Trail and its application with Softwars, Issues under GST, Technology under DAAB etc.

I would like to take the opportunity to sincerely thank all the contributors of Newsletter and aspecial thanks to the editorial board for releasing such an amazing newsletter: "I can do things you cannot, You can do things I cannot, Together we can do Great Things."

CA. Swarnim Gupta

(Secretary-Indore Branch of ICAI)



MANAGING COMMITTEE

CA. Mausam Rathi (Chairman), **CA. Swarnim Gupta** (Secretary),
CA. Atishay Khasgiwala (Vice Chairman), **CA. Amitesh Jain** (Treasurer),
CA. Rajat Dhanuka (CICASA Chairman)
Exe. Member : **CA. Anand Jain** (Imm Past Chairman),
CA. Samkit Bhandari, **CA. Ankush Jain**, **CA. Jayesh Shah**
Ex. Officio Member : **CA. Kemisha Soni** (CCM),
CA. Kirti Joshi (RCM) **CA. Sharad Jain** (RCM)



VALUATION

UNDER VARIOUS STATUTES

CA. Saloni Aayush Garg



To go by definition, Valuation is the analytical & quantitative process of determining the current or projected net worth of an enterprise as a whole. Although, being quantitative in nature, valuation often involves substantial degree of subjective inputs or assumptions. Valuations can be conducted using multiple methods/techniques, depending upon the purpose of such valuation. Valuation is always dynamic; it changes according to situation; scenario; size and purpose. Unfortunately, there's no one straight jacket valuation method that's best suited for every situation. Each asset is different, each industry or sector has unique characteristics and each statute has different set of requirements that may necessitate multiple valuation methods. At the same time, every valuation method may produce different value for the same underlying asset or entity which, in turn, very often gives a high degree of discretion to the entity to obtain the valuation report best suitable for its purposes.

In order to curtail & combat the subjectivity and arbitrariness of valuation mechanisms, statutes such as the Income-Tax Act, 1961 ['I.T. Act'], the Companies Act, 2013 and the Foreign Exchange Management Act, 1999 ['FEMA'], have prescribed their own valuation methodologies.

Nowadays, business houses are required to go under valuation process at different stages of their business,

in different circumstances and therefore, sometimes, they fall under the mischief of provisions of more than one statute. For instance, for fresh issue of shares by a Private Limited Company to an overseas shareholder, the company will not only be required to comply with the Valuation mechanism as designed under the Companies Act, 2013, but also under the provisions of FEMA and I.T. Act.

This paradigm shift in valuations, from the absolute discretion to a prescribed manner indicates that companies are now required to comply with valuation requirements even on an ongoing basis. Now, in this challenging environment, a valuation practitioner is required to properly navigate all the provisions of an Act or Rule, and all the relevant laws that are attracted to a particular scenario of valuation. Thus, a valuation practitioner needs to be updated all the time and must possess a holistic approach towards valuation.

VALUATION UNDER THE INCOME-TAX ACT, 1961

Under the I.T. Act, there are various sections involving valuation of shares or securities or any other capital asset. A table summarising the situations contemplated under such Act requiring application of valuation is enumerated below:

| Relevant Section of I.T. Act | Determination of Fair Value in case of | Relevant Rule of I.T. Act | Remarks |
|------------------------------|---|---------------------------|--|
| 56(2)(vii)(b) | Issue of Unquoted Shares to an assessee including a non resident assessee w.e.f.01-04-2023[A.Y. 2024-25], at a premium. | Rule 11UA(2) | Higher of the following two : (I) The value determined as under by any of the following two methods, at the option of assessee: I $(A-L)*PV/PE$ [Refer Note 1] I Value determined by a merchant Banker as per the Discounted Free Cash Flow method , Or (ii)the value as may be substantiated by the company to the satisfaction of Assessing Officer. |
| 56(2)(x) | Property received by any person as a Gift {i.e. without consideration or for inadequate consideration} | Rule11U and 11UA | Refer Note 2, <i>infra</i> Property means any capital asset including shares ; securities; jewellery; bullion ; archaeological designs; drawings; paintings; sculptures; any work of art. |
| Section 50CA | Transfer of an unquoted share | Rule 11UAA | Reference made to Rule 11UA(1). |

Note 1 :Rule 11UA(2)

[For the purpose of Valuation of Unquoted Shares under s. 56(2)(vii)(b)]

To be conducted as per Audited Balance Sheet on the valuation Date or an Audited Balance Sheet drawn on a date immediately preceding the valuation date which has been approved and adopted in the AGM of the company using the following formula:

$(A-L)*PV/PE$, where,

I A= Book value of the assets in the balance-sheet as reduced by any amount of tax paid as deduction or collection at source or as advance tax payment as reduced by the amount of tax claimed as refund under the Income-tax Act and any amount shown in the balance-sheet as asset including the unamortised amount of deferred expenditure which does not represent the value of any asset;

I L=Book value of liabilities shown in the balance-sheet, but not including the following amounts, namely:—

- (I)** the paid-up capital in respect of equity shares;
- (ii)** the amount set apart for payment of dividends on preference shares and equity shares where such dividends have not been declared before the date of transfer at a general body meeting of the company;
- (iii)** Reserves and Surplus
- (iv)** Any amount representing provision for taxation
- (v)** any amount representing provisions made for meeting unascertained liabilities
- (vi)** any amount representing contingent liabilities other than arrears of dividends payable in respect of cumulative preference shares;
- I** PE= Total amount of paid up equity share capital as shown in the balance-sheet;
- I** PV= The paid up value of such equity shares; or

Note 2 : Rule 11UA(1)

[For the purpose of Valuation of Property and Unquoted Shares under ss. 56(2)(x) and 50CA]

JEWELLERY

[Rule 11UA(1)(a)]

- (i) Price it would fetch if sold in open market on the valuation date
- (ii) Invoice Value in case of purchase from a registered dealer
- (iii) In other cases, As per report of a registered valuer {if the value exceeds RS 50,000}

ARCHAEOLOGICAL

Collections/Paintings/Drawings/
Any Work of Art [Rule 11UA(1)(b)]

- (i) Price it would fetch if sold in open market on the valuation date
- (ii) Invoice Value in case of purchase from a registered dealer
- (iii) In other cases, As per report of a registered valuer {if the value exceeds RS 50,000}

UNQUOTED EQUITY SHARES

[Rule 11UA(1)(c)(b)]
(A +B +C+ D-L) * PV/PE

QUOTED SHARES AND SECURITIES

[Rule 11UA(1)(c)(a)]

- (i) Transaction Value as recorded in recognised stock exchange
- (ii) In case of transaction carried out other than stock exchange,
 - a) Lowest price of such shares and securities quoted on recognised stock exchange on the valuation date or a date immediately preceding the valuation date, if no trading done on the valuation date

UNQUOTED SHARES AND SECURITIES

(other than Equity Shares)

[Rule 11UA(1)(c)(c)]
Price it would fetch if sold in open market on the valuation date as per a report obtained from a Merchant Banker or an accountant

Valuation of Unquoted Equity Shares as per Rule 11UA(1)(c)(b)

To be conducted As per Audited Balance Sheet on the valuation Date using the formula : (A +B +C+ D-L) * PV/PE, where

- A= Book value of all the assets (other than jewellery, artistic work, shares, securities and immovable property) in the balance-sheet as reduced by,—
 - (i) any amount of income-tax paid, if any, less the amount of income-tax refund claimed, if any; and
 - (ii) any amount shown as asset including the unamortised amount of deferred expenditure which does not represent the value of any asset;
- B = the price which the jewellery and artistic work would fetch if sold in the open market on the basis of the valuation report obtained from a registered valuer;

- C = fair market value of shares and securities as determined in the manner provided in this rule;
- D = Stamp duty value in respect of the immovable property;
- L= Book value of liabilities shown in the balance sheet, but not including the following amounts, namely:—
 - (i) the paid-up capital in respect of equity shares;
 - (ii) the amount set apart for payment of dividends on preference shares and equity shares where such dividends have not been declared before the date of transfer at a general body meeting of the company;
 - (iii) reserves and surplus, by whatever name called, even if the resulting figure is negative, other than those set apart towards depreciation;

(iv) any amount representing provision for taxation, other than amount of income-tax paid, if any, less the amount of income-tax claimed as refund, if any, to the extent of the excess over the tax payable with reference to the book profits in accordance with the law applicable thereto;

(v) any amount representing provisions made for meeting liabilities, other than ascertained liabilities;

(vi) any amount representing contingent liabilities other than arrears of dividends payable in respect of cumulative preference shares;

- I PV= the paid up value of such equity shares;
- I PE = total amount of paid up equity share capital as shown in the balance-sheet;]

POINTS TO PONDER UPON:

1] DATE OF VALUATION?

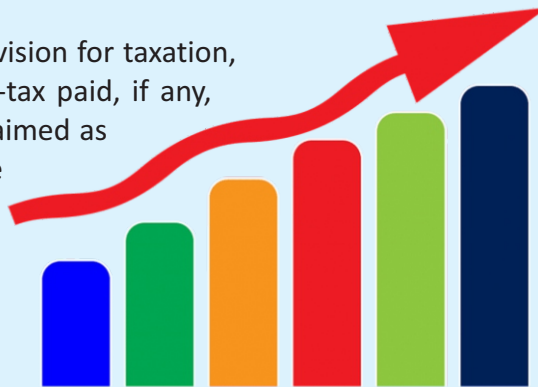
It is highly fascinating to note that, for the purposes of section 56(2)(vii)(b), an assessee can use the financial data as per the last drawn Audited Balance Sheet of the company. However, in other cases viz. ss. 56(2)(x) and 50CA, an assessee needs to ensure that the company, whose shares are being transferred, get its accounts audited as on the valuation date. However, whether a shareholder purporting to transfer his shares can control the Auditor of a Company to issue a Audited Balance Sheet on a given date in the mid of the financial year is a question to ponder upon!!!

2] CASE OF CROSS HOLDINGS?

The Valuation Rules does not contemplate a situation of cross holding of shares by companies. Say if Company A and Company B hold shares in each other's companies, then the valuation of Company A will depend upon valuation of Company B's, which in turn, will depend upon Company A's valuations. It will thus give rise to a situation of circular loop and no FMV of each of the companies will be able to be determined!!!

3] VALUATION UNDER S. 50C/43CA VIS-A-VIS RULE 11UA

The valuation Rules mandates an assessee to use the Guideline Value of immovable property for the



purpose of valuation of an unquoted share. Although, while making valuation under s. 50C/43CA a tolerance band upto 110% of consideration received has been prescribed, but while making valuation under the said rule, the benefit of the aforesaid tolerance band has not been conferred upon.

Further, under s. 50C/43CA, reference to DVO can be made, but no such reference can be made while computing the FMV of the same land under the subject Rule 11UA. Thus, although assessee can be benefitted from the liberalized provisions under ss. 43CA and 50C, but no such benefits can be enjoyed for the purpose of determination of FMV of the company!!!

4] WHETHER BUY-BACK OF SHARES WOULD ATTRACT PROVISIONS OF SECTION 56?

It has been held in various judicial pronouncements that Buy-Back of its own shares by a company does not fall within the mischief of the provisions of s. 56(2)(x) of the Act in the hands of the company.

VALUATION UNDER THE COMPANIES ACT, 2013

Valuation is also required under the Companies Act, 2013 for any securities, stocks, property, debentures, shares, or goodwill, or any other assets or for computing the net worth of a company, or the liabilities of the company under the following sections of the Act:

- I Section 62- Further Issuance of Shares
- I Section 230- The power to compromise or make arrangements with creditors and members.
- I Section 232- Corporate mergers and amalgamations
- I Section 236- Purchase of a minority stake in a company
- I Section 260- Company Administrator's Authority and Responsibilities
- I Section 281- Report Submission by Company Liquidator
- I Section 192 :Valuation of Assets that are Acquired for Consideration Other than Cash by Directors of the company/group company

Valuation mechanism under the Companies Act, 2013 is governed by Section 247 of the Act read with Companies (Registered Valuers and Valuation) Rules, 2017, which sets out various guidelines for qualification, independence, and methodology of working as a registered valuer under the Companies Act 2013. Section 247 permits only Registered Valuers to undertake valuation of any stock, share, debenture, security, goodwill, asset, liability or net worth of the company as required under this Act. As per the aforesaid Rules, for obtaining the certification as a registered valuer every candidate needs to pass the examination and obtain certification as a “Registered Valuer” from the Insolvency and Bankruptcy Board of India (“IBBI”) established under the Insolvency and Bankruptcy Code, 2016. The Act requires a true, fair, and impartial valuation to be performed and prohibits the registered valuer from undertaking valuation of any asset in which he is interested, whether directly or indirectly, at any time during a period of three years before or after the valuation.

VALUATION UNDER THE FOREIGN EXCHANGE MANAGEMENT ACT, 1999

The Pricing / Valuation Guidelines are also governed by The Foreign Exchange Management Act, 1999 (FEMA), Foreign Exchange Management (Transfer or Issue of Security by a Person resident Outside India) Regulations, 2017 and RBI notification & regulations issued and updated from time to time. Valuation under the provisions of FEMA Act is required under the following situations:

Overseas Direct Investment (ODI) valuations

- It means transfer or acquisition of shares by a resident in an overseas company; or formation of a wholly owned subsidiary or Joint venture outside India by any resident of India.
- No specific methodology has been prescribed for the same.

Foreign Direct Investment (FDI) valuations

- It means issue or transfer of Indian company's compulsory convertible instruments or equity shares to a non-resident.
- It is governed by internationally accepted principles as the basis of valuation. Discounted Cash Flow technique and Net Assets Value Method are primarily accepted as internationally accepted methodology.

- The valuation under FEMA can be performed by a Chartered Accountant or a Certified Public Accountant or a Merchant Banker. However, in situations involving share swaps or transaction value exceeding \$5 Million, the valuation can only be performed by a Category I Merchant Banker registered with SEBI.
- Valuation done for FDI/ODI transactions is valid for a period of 6 months. Therefore, the transaction should be completed with 6 months from Date of Valuation.

CONCLUSION

It may be noted that no professional has been vested with authority of valuation with respect to all laws. Hence it brings a lot of redundancy and adds to the costs of the business houses. Further the values arrived at under different enactments also vary due to

subjectivity involved and as also due to diversity in the regulations of the statutes. To combat this, the Government should definitely come up with respective amendments in statutes to bring out uniformity of procedures, avoid duplication of work and save the time and costs of business. As a welcoming move, the recognition of Registered Valuer in laws like Insolvency and Bankruptcy Code and SEBI Regulations aligning it with the Companies Act is highly appreciable and widely accepted by the Commerce and Industry Professionals across the nation. Looking at the increasing scope and need of the Valuation exercise in near future, it is expected that a standard set of Rules and Regulations governing Valuation Procedure will be soon brought into force.

TAX HAVENS



MEANING - A country where taxes are low and where people choose to live or officially register their companies to avoid paying high taxes in their own countries.

A tax haven, or offshore financial center, is any country or jurisdiction that offers minimal tax liability to foreign individuals and businesses. Tax havens do not require businesses to operate out of their country or the individuals to reside in their country to receive tax benefits.



CA. Ayushi Garg CA. Anshika Goyal

EXAMPLE:

Top 10 Tax Haven Countries in the World - Tax Justice Network 2021 (CTHI value):

| | | | | |
|------------------------|----------------|---------|-------------|----------------------|
| British Virgin Islands | Cayman Islands | Bermuda | Netherlands | Switzerland |
| Luxembourg | Hong Kong | Jersey | Singapore | United Arab Emirates |

CRITERIA FOR TAX HAVENS:

In 1998, the Organization for Economic Cooperation and Development (OECD) gave a number of factors to identify tax havens. Some of the most common factors are given below:

- No, or nominal, tax on relevant income ■ Lack of effective exchange of information
- Lack of transparency ■ No substantial activities

LEGAL ISSUES WITH TAX HAVENS:

Tax havens exist in a legal gray area in that many of the activities associated with them are legal, but many are not. For example, using a tax haven to store funds earned overseas, thereby avoiding paying higher taxes in one's home country, is legal. So is funneling investments in a trust or company through a tax haven.

On the other hand, using a tax haven to hide earnings entirely, or to launder money earned through illegal means, is not legal.

Although the definition of what exactly counts as a tax haven differs from source to source, modern tax havens typically adhere to guidelines set out by regulatory bodies such as the Organization of Economic Cooperation and Development (OECD) and the U.S. Government Accountability Office. Modern corporate tax havens have high levels of OECD compliance and establish bilateral tax treaties, which are legal agreements between two countries that reduce the rate of taxation for businesses located in one country but earning money in another. Many tax havens have the ability to legally enable tax treaties close to zero by using base erosion and profit shifting tools (BEPS).

TAX IMPLICATIONS IN VALUATION AND FINANCIAL MODELING:

When performing a company valuation, the calculation of taxes can have a material impact on cash flow.

A financial analyst is tasked with building a forecast of what they expect revenue, expenses (including taxes), and other financial items to be in the future. This process of forecasting items into the future is known as financial modeling and is performed in Excel.

HOW DO TAX HAVENS WORK?

- I Shell companies- a shell company is a legal entity created in a tax haven. Shell companies typically exist only on paper, with no full-time employees, and no office. They are called shell companies because there is nothing inside. A shell company exists only on paper.
- I Are shell companies illegal? – Shell companies are not illegal. It may however, depend upon the use for which the company is being used. Purchasing an expensive asset in company's name is legal while hiding stolen assets abroad is illegal.
- I What benefits to tax havens bring to companies and governments- Through subsidies in foreign financial centres, companies get to save huge amounts of taxes. For governments, they are beneficial as- firstly, they are not completely tax free. A nominal amount of tax has to be paid by companies. High customs/ import duties usually cover the losses suffered because of low tax rates. Secondly, tax havens may charge for a nominal registration or license fee and renewal charges to be paid every year.

The Panama papers case which leaked 11.5 million leaked documents that was published on 3rd April 2016 which contained financial and attorney details of more than 2.14 Lakhs offshore entities by a law firm and corporate service provider M/s Mossack Fonseca. Most of the documents showed no illegal actions, but some of the shell corporations set up by Mossack Fonseca had been used for fraud, tax evasion, or avoiding international sanctions.

ADVANTAGES AND DISADVANTAGES OF TAX HAVENS:

The fundamental benefit of holding an offshore corporation or other financial vehicle in a tax haven, as the name implies, is the enormous tax savings it gives.

The advantages, however, are not confined to taxation. The following are some of the advantages of offshore tax havens:

Reduction of Taxes:

The majority of industrialized Western countries have highly high, progressive tax regimes, in which top incomes and businesses lose a considerable portion of their earnings to taxes. This is why so many people are going to tax havens to lawfully reduce their tax burden. Offshore corporations can expect to pay extremely low or no taxes in prominent tax havens because of their advantageous tax policies. Antigua and the Cayman Islands, for example, levy no corporate income tax, capital gains tax, personal income tax, inheritance tax, or other taxes on offshore corporations. Many other offshore tax havens have tax systems that are comparable to this one, with few or no taxes at all.

Convenience:

Offshore tax havens are meant to entice rich people, corporations, and investors to set up offshore financial structures. They create favourable financial conditions and, as a result, gain from the economic inflow brought by offshore investors. This also implies that most tax havens make incorporating or establishing any type of financial instrument relatively straightforward, simple, and quick.

Privacy:

Offshore tax havens provide far more secrecy and non-disclosure. There are usually limited reporting or auditing obligations, and information about the corporation and its beneficial owners is not visible to the general public. Tax havens are perfect for shielding one's money and assets from unwanted attention and inquisitive eyes, and so assist in protecting assets against confiscation, litigation, and divorce, among other things.

Protection of Assets:

Offshore tax havens are suitable locations for asset protection. This is due to the fact that they operate outside of the regulatory and legal frameworks of the United States, the European Union, and other industrialised Western nations. This makes it exceedingly difficult for local court decisions to have

any impact on your efforts to recover your offshore assets and/or taxes. There are certainly several advantages to utilising offshore tax havens intelligently. There are, however, some possible downsides. These are mostly attributable to public perceptions of offshore tax havens as being untrustworthy. Whether or not these assertions are correct, the unfavourable publicity that these tax havens have received has undoubtedly resulted in some of the following disadvantages:



Issues with Corporate Bank Accounts:

Many respectable banks consider corporations based in tax havens to be higher-risk clients. This is likely to lead to more stringent due diligence procedures and a decreased likelihood of getting approved for a corporate account.

Outside Investors tend to refuse the Investments:

Outside investors may be hesitant to participate in a firm that operates through an offshore tax haven due to the same reasons as previously noted (whether valid or not). This isn't a problem for offshore tax haven vehicles that are just employed as holding corporations or for individual asset protection, but it can have serious implications for active firms.

Additional Scrutiny:

Businesses that use tax havens may be exposed to greater scrutiny from their local regulatory authorities in the form of tax audits and other investigative actions as a result of some of the rising unfavourable views about them. Some consumers and suppliers may be wary of doing business with you and hence avoid doing so.

The **Cayman islands** are favorite among corporations and financiers as there are no corporate taxes here. It shield them from substantial and increase taxes.

Bermuda island also does not have any income tax as Bermuda focuses on privacy for potential bankers is also best among the world. Over 75% of Fortune 500 companies have a presence here.

The **Bahamas** is the ultimate dream of any corporation with its lack of any form of tax. Banks in the Bahamas are discreet and reputed for their lack of transparency and privacy.

The island nations of **Mauritius** is isolated and the key users of this tax shelter are mostly Indian companies.

Singapore besides being a tourist destination, Singapore is known for its normal corporate taxes. As the heart of trade, business and economy in the region Singapore allows investors and companies to pay lower taxes.

Switzerland- The swiss are probably most popular for their successful and robust financial institutions, you must have heard about swiss bank. The country is popular for its consistent reliability when it comes to offshore tax shelters.

The worlds top tax haven the **British Virgin Island**, holds more than 5000 times the value of what economy should hold. The self governing overseas territory of the UK was one of the 30 countries blacklisted as a tax haven by the EU in 2015.

TAKEAWAY:

Tax havens are countries that allow foreign investments at very low rates of interest. The aim behind this is to increase foreign direct investment in the country's market. For the companies, it is a big advantage to the fact that they evade tax, legally. In context to the Indian economy, while tax havens bring a plus side to the companies, the government struggles to manage hybrids, interest rates, distribution of wealth etc. The biggest tax havens for Indian investors are Cayman Islands, Luxembourg and Switzerland. For any country to become a tax haven, there are certain criteria to be fulfilled. This criterion has been mentioned by the Organization for Economic Co-operation and Development (OECD). Shell companies are established for the purpose of this legal tax evasion.

STATUTORY BANK BRANCH AUDITS

(PRACTICAL APPROACH & SHORT CUTS)



CA. Prakash Wohra



IT'S TIME FOR QUALITY CHANGE

As we all know that change in every movement of life is inevitable and we have to accept it. With the rapid changes in upgraded technologies, incremental trend in digitalization and global financial market, our role and responsibilities as an auditor have increased manifold and expectations of regulators are bound to be high. It is therefore essential for all of us to be equipped with latest techniques and updated knowledge of audits of banks and/or its branches.

TIME MANAGEMENT

It has become an essence of every audit exercise and bank branch audits are not exception to it. It is therefore necessary to plan the audit exercise in such a manner to extract the best output within limited time frame. Well planned audit programme, formation of quality team with adequate knowledge of banking system always helps and make the entire exercise more fruitful. Otherwise casual and unplanned audit approach may result in big chaos.

PLANNING AND EXPECTATIONS

To plan for effective and fruitful audit process we need to understand the expectations in statutory bank branch audit, our duties in that regard and the order in which we must proceed.

1. Important Preliminary Work are:

Acceptance letter, NOC from previous auditors, Issue of audit engagement letter as per SA-210, Familiarity with RBI circulars and Institute guidance note, Accounting policies of the Bank, Letter to the Branch manager for requirements for the purpose of the audit, Preparation of audit program and its execution, Lay down an overall time schedule, Ensure that the audit staff is adequately trained and there is sufficient skill and competence for specialised areas, Keep flexibility in the Audit plan for giving extra focus on weak areas identified during the course of audit and Co-ordination with the Branch Management.

2. Auditing Standards and Peer Review:

With all the mandatory Auditing Standards and Peer Review requirement in place, it is imperative that Auditing Standards of ICAI are complied with specially SA 210, 220, 230, 300, 310, 320, 400, 500, 530, and 580 which are more relevant for bank branch audit.

REPORTING:

This is the ultimate and vital tool in bank branch audit where we can express our opinion in a summarized form. In a bank branch audit, following reports are to be prepared:

1. Statutory Audit Report.
2. Memorandum of Changes
3. Tax Audit Report.
4. Long Form Audit Report.

1. STATUTORY AUDIT REPORT ALONG WITH MOC:

This is the prescribed report format under Banking Regulation Act. As such this is to be given strictly in the same format. However we have the choice to report our observations by way of attachment of special observation sheet to the main report. It is nothing but an integral part of our statutory audit report. Likewise any changes required in the financial statements, authenticated by us, can be reported in Memorandum of Changes. It also becomes integral part of main audit report.

2. TAX AUDIT REPORT:

Now a day in most of the banks this report is centralized at ZO/HO level. But wherever it is required it has to be furnished very carefully. Despite non applicability of such report at branch level some critical points are to be verified cautiously and discrepancies observed, if any, should be reported in LFAR as other matters.

a. Declarations from employees regarding investments and other allowable deductions along with proof of payments such as copy of LIC receipts, Rent receipts, NSC/PPF receipts, school fee receipts etc. should be checked properly.

b. Though delay in submission of Forms 15 G/H, e payments, e TDS returns etc. are not required to be reported in TAR but it is important for reporting in LFAR. Hence caution must be exercised on this front also.

3. Long Form Audit Report: (LFAR)

LFAR is the ultimate and vital tool for our reporting purposes and we must be fully aware how to use it. While the observation sheet attached to and forming part of statutory audit report is explanatory of critical deficiencies noted/observed during the course of audit, LFAR is a comprehensive report on the working of bank branch.

SOME OBSERVATION ON AUDIT REPORTS:

a. Inconsistencies in audit reports:

Irregularities like overdue for review, non- submission of stock statements in adequate recoveries are reported in LFAR at various places but accounts are neither considered as NPA nor suitable disclaimer are made in main audit report. This leads to contradiction in our own reporting & needs due care and attention.

b. Reporting in LFAR:

We have to be very specific in reporting the deficiency along with no. of samples taken and verified. Vague reporting is no reporting. Hence general remarks should be avoided.

c. Report on Ghosh/Zilani recommendations:

This is fixed format wherein we need to reply in “Yes” or “No” or “N.A.” only. It is not possible for us to take the responsibility of all the concerned areas for the whole year where we do not have our check and control. It is therefore advised that while signing this questionnaire, we should always make some disclaimer and reference of samples to avoid unwarranted hardship.

CLASSIFICATION OF ADVANCES:

Basically there are two types of classification in the loan portfolio i.e. Security wise classification and Asset wise classification. Further these are divided in to sector wise classification i.e. Priority Sector, C & IC and so on. These are further divided in to various natures of loans such as Term Loan, CC/OD, BP/BD etc.

To understand in better way the security wise classification we need to understand the basic nature of loan facilities & their common classification as under:

! Housing loans, Loans against FDRs/NSC, Mortgage Loans, Staff vehicle loans are generally considered fully secured only. If there is deviation from it, immediate attention should be given on value of security filled in the statement of advances.

! Some common errors can be as under:

a. Original value of security is not revised but the value has gone up due to accrual of interest on securities i.e. FDRs, NSC etc.

b. Value of security in case of housing loan has been considered at sanctioned limit value only and no further revision to the extent of Market Value.

c. Value of collateral security, if any, has not been considered.

d. Value of security in the statement has not been timely updated based on latest stock and debtors statements.

! **Staff Loans:** Generally all staff loans are considered secured by the branch. But certain loans are granted to them as clean loan and no security document except for DP note and installment letter is obtained. In absence of any tangible forcible security available with the bank these loans cannot be considered as secured in any case.

Unlike security wise classification, asset wise classification is equally or rather more important. There are four types of loans/advances in this classification i.e. Standard Assets, Sub Standard Assets, Doubtful Assets and Loss Assets.

Important aspects to be kept in mind:

Actual process of loans and advances starts from sanction up to the level of monitoring and supervision as under:

1. Loan Application: Should be complete with attachment of all supporting documents such as financial statements, tax returns, guarantor's details etc.

2. Credit Appraisal: should be based on available documents mentioned above and norms prescribed by RBI and HO circulars/instructions.

3. Sanction, documentation and disbursement : With clarity with respect to facility wise and security wise details, other terms and conditions with regard to term of loans, rate of interest, disbursement and repayment schedule & other mandatory terms as per HO circulars.

4. Documentation: Execution of security documentation with adequate stamp duty and mortgages, if any. Disbursement should be made only after proper execution of security documents.



5. Monitoring & supervision: This is very important task in the entire process & following points to be kept in mind:

- a. Timely submission of stock statements, adequate insurance cover from time to time, and submission of periodical financial/QIS returns, data and timely verification of the same is equally important.
- b. Proper and accurate determination of drawing power to determine the excess drawings, if any, which may result in to NPA if continued to be out of order for more than 90 days.
- d. Post disbursement inspections at periodical intervals and its written reports are also essential for effective supervision.
- e. Frequent over drawings, irregular credits in the bank accounts, non-submissions or late submissions of stock statements, large amount transactions without proper justifications, frequent inter firm/associate firm transactions etc. are the key indicators for proper monitoring of a loan account. Any lapse on this part may lead to turn the account into NPA.
- e. Periodical balance confirmations certificates have to be obtained from the borrower so as to keep the security documents live.

6. Periodical Review:

- a. All such loan accounts become due for review every year. Branch officer has to call for latest statements, audited financial data, latest search reports, list of shareholders and directors, copy of latest I.T. Returns etc. required for appraisal and review of loan account and to consider all such aspects once again as if it is new sanction and have to carry out physical inspections as well.
- b. Any pending deficiency in security documents, insurance cover, title of goods, adverse comments of internal or concurrent auditors have to be scrutinized thoroughly before final review.
- c. Upon final review, necessary processing charges have also to be recovered from the borrower.

PRUDENTIAL NORMS FOR NPA ACCOUNTS:

It is mandatory for all branches to adhere to the prudential norms for NPA accounts and income recognition and provisioning thereof. Here are the some of the specific points to be considered:

- a. Proper identification of asset as NPA in different category. Even an asset can become direct loss asset

without passing through the various stages.

- b. Non submission of stock statements for continuous 90 days or more will turn the account in to NPA.
- c. Accounts overdue for review for more than 90 days will also turn the account in to NPA.
- d. Mere technical review of accounts instead of complete review is also not permissible for prudential norms.
- e. Special attention needed:
 1. Term Loans overdues:
Additional interest on delayed payments and penal interest for over dues, if any, to be paid along with regular payments only. Any delay will be considered as overdue.
 2. Advance repayment of loans:
 - If parked separately in sundries than it can be appropriated on due dates.
 - If credited in the loan account and tenure is reduced or repayment schedule is modified than revised schedule will be considered.
 - If the advance amount is neither parked separately nor tenure is reduced by appropriating towards subsequent EMIs than it will be presumed to have been recovered the loan amount to that extent on that day and it will not be available for future EMIs.
 3. Potential threat of recovery:
 - If realisable value of security is less than 50% of the value assessed by the bank – Straightway it is doubtful category
 - If realisable value of security is less than 10% of the outstanding balance–Straightway it is Loss category
 4. Mandatory Valuation:
 - Outstanding more than 5.00 Crores- Stock Audit by external agencies.
 - Immovable Properties to be valued in every three years by approved valuers.
 5. Regularisation after balance sheet date:
 - Not material and not to be considered for up gradation on balance sheet date.
 6. Fee, commission and other items that have



accrued in the current period should also be reversed, if uncollected.

SUGGESTED SHORT CUTS/ TRICKS:

To begin the audit process we must first ask the branch management to provide us the list of periodical computerized reports generated by them from time to time.

Some of the computerized reports are : (List is illustrative and not exhaustive)

1. Exceptional Transactions Report. 2. Change of Passwords Report 3. Change in rate of interest rates from time to time as per general RBI circulars

4. Change in rate of interest rates from time to time as per specific instruction circulars of respective bank.

5. Break down reports 6. Disaster management policy

7. Report for communication of change in rating or charging penal interest etc. It is specific report and this communication is normally sent by the concerned branch only. 8. Transactions in inoperative accounts.

Similarly we should ask them to provide us the list of periodical returns furnished by the branch to their controlling authorities. Some of the periodical returns (List is illustrative and not exhaustive) are as under:

1. Rotation of staff duty reports. 2. Reporting of irregular loan accounts 3. Periodical review of loan accounts 4. Reports on sensitive items like stationery items, tokens etc. 5. Report of fraudulent transactions or Frauds occurred if any. 6. Regular follow up reports.

7. List of Potential NPA accounts. 8. Periodical summary of NPA accounts. (Existing as well as doubtful cases) List of some audit reports available at branch is as under:

1. System Audit Reports
2. Internal Audit (Circle Audit) Reports
3. RBI Inspection Reports
4. Concurrent Audit Reports, if any.
5. Special Audit Reports, if any.
6. Other audit /investigation reports, if any.

From the first hand study of these returns/reports, we can extract some ideas/clues where we need to give special attention and check the deficiencies. These returns/reports are very important and helpful in analyzing and finding observations on internal controls system applied at the branch level. These are

important for our reporting on GHOSH & ZILANI COMMITTEE REPORTS and LFAR also.

OTHER SHORT CUTS:

From the value of security and corresponding insured sum, deficiency can be noted for LFAR purposes also.

It is to be noted that in case of composite facilities enjoyed by the borrower, even if one account goes out of order and turned as NPA, entire outstanding balances in all such borrower accounts shall be treated as NPA.

High value accounts should be separated and sample can be drawn on that basis only.

Specially in case of fresh loans, sometimes it is observed that these documents are either left blank or incomplete. This is the check point for such incomplete documents and no. of deficiencies can be detected for LFAR reporting purpose.

While drawing samples, more emphasis should be given to new loan accounts sanctioned and disbursed for the purpose of quality of loan appraisal, adherence to terms and conditions mentioned in sanction letter, documentation, obtaining of adequate data/financial statements, copies of IT/GST return etc. These are the items which are to be reported in LFAR.

SAMPLING:

It mainly relates to security documents, appraisal files, insurance covers, stock statements, periodical reviews and relevant financial statements etc. While drawing samples of borrowers, files and relevant statements, documents, financial statements, copies of IT Return/VAT returns etc. should be obtained as complete set. It will help us in cross verifications of relevant data, terms of sanction letter and its adherence, set of security documents with list given in sanction letter and so on and so forth. If this is scrutinized by one person at one go it will save much time and we can avoid duplicity of work.

However to check the security documents, one should try to check at least two or three documents (may be more if time permits) of each type of facilities granted by the bank. It includes OD against FDRs, Vehicle Loans, Corporate Loans under CC and/or term loan facilities, govt. sponsored scheme loans, other staff loans, agriculture term or CC loans, tractor loans in case of agri-finance etc.

OTHERS:

a. Guarantees and Letter of Credits: Consequent upon devolvement of LC or guarantees invoked, sometimes bank has to pay off such liability and it becomes loan. In case the dues are not recovered in time, it becomes NPA and calls for provisioning norms as well.

b. Sensitive items: This is fraud prone area and needs special attention. It includes stationery and stamps, sundry and suspense accounts etc. While checking these items we have to be cautious regarding the age of outstanding, proper and adequate internal control procedures, physical verification of sensitive stationery items like unused cheque books/draft books, travelling cheques, gift cheques, ATM cards/Debit cards/PINs/Retained cards/payment tokens etc. Any missing/lost items have to be strictly reported by the auditors.

c. Deposits: Besides normal procedure of opening of accounts, follow up of KYC norms, special attention is needed on in-operative accounts. Auditor must ensure that proper guidelines laid down by the controlling authorities have been followed. No frequent or unauthorized transactions are allowed in such in-operative accounts.

d. Window dressing: Any unusual large movements in deposit accounts are also key indicators of irrational transfer of funds, window dressing etc. Possibilities of diversion of loan funds through this route also cannot be ruled out.

PROFIT & LOSS ACCOUNT:

a. Being computerization in most of the branches calculation of interest and other charges are automatic. However there has to be proper system to record and amend the correct rate of interest on the basis of scheme codes.

b. From time to time, internal auditors, revenue auditors and concurrent auditors also detect such errors. These also needs to corrected in the same year's P & La/c. Otherwise it becomes a matter of MOC.

c. An auditor must exercise due care in comparing major heads of revenues and expenses to report divergent trend, if any.

GENERAL:

1. Audits and Inspections:

While compiling LFAR, an auditor must go through the

previous year audit reports, reports of internal and concurrent auditors, RBI officers or special audit report, if any. From such reports, if we find any persisting irregularity, than it has to be brought to the notice of management through LFAR.

2. Frauds:

In case of fraud detected at the branch during the year, records/registers maintained by the branch have to be checked carefully. On the basis of our observations and test checks, if we come across any lacuna in the internal control procedure followed by the branch, we must give our suitable comments thereon in the LFAR.

3. Miscellaneous:

This is a column where we can give our comments on all such matters which have not been covered in the above clauses. This includes window dressing, housekeeping and maintenance of records, records of fixed assets or any other major observations which auditor wants to bring to the knowledge of the management.

CERTIFICATION:

In addition to financial statements, statutory reports, LFAR etc. we, statutory auditors have to sign some significant certificates as well In this context please note that each and every certificate has its own relevance and required for some or the other specific purposes. Some of them are for controlling purposes, some are for govt. agencies which provide subsidies or other concessions under various govt. schemes and some are related to information's to be provided to Reserve Bank of India under compulsory norms like SLR/CRR etc.

As such these certificates are important not only for internal use of bank or central statutory auditors but for other independent external entities as well. As such bank branch auditors owes the legal responsibilities and are directly accountable to them for any misrepresentation or wrong certification on their part. Hence we need to be extra cautious and vigilant while certifying the data, contents of these certificates.

CONCLUSION:

From the above it is clear that audit verification, certification and reporting are equally important and related to each other. Our entire approach in bank branch audit must be to give our precise, firm and categorical report with utmost care, due diligence and positive attitude.

INDIRECT TAX CASE LAWS



1. Gujarat Maritime Board vs. Commissioner of Central Excise & Customs (2020) (SC)

In this case, the Supreme Court held that the levy of service tax on the port services provided by the Gujarat Maritime Board to various users was unconstitutional, as it was in excess of the powers conferred by the Constitution of India.

2. Union of India vs. Adfert Technologies Pvt. Ltd. (2021) (SC)

The Supreme Court held that the Central Goods and Services Tax Act, 2017 cannot be retrospectively applied to impose tax liability on taxpayers for the period prior to its enactment.

3. Siddharth Enterprises vs. Commissioner of Central Excise (2021) (SC)

In this case, the Supreme Court held that the government cannot deny input tax credit to a taxpayer on the ground of technicalities, when the taxpayer has fulfilled all the conditions for claiming such credit.

4. Tata Sons Ltd. vs. Union of India (2021) (SC)

The Supreme Court held that the levy of GST on recovery of expenses incurred by the employer on behalf of the employee, such as rent paid for employee accommodation, was unconstitutional, as it violated the principles of mutuality and was arbitrary and discriminatory.

5. Megha Engineering & Infrastructures Ltd. vs. State of Telangana (2020) (SC)

In this case, the court held that the Tax department

cannot levy tax on the provision of temporary works contract services as it falls under the exempt category.

6. Union of India vs. Intercontinental Consultants and Technocrats Pvt. Ltd. (2020) (SC)

The court held that there cannot be any imposition of GST on supply of goods and services to foreign companies located outside India, where such supplies do not involve a taxable territory.

7. Commissioner of Central Tax vs. Radha Krishna Foodland Pvt. Ltd. (2020) (SC)

In this case, the court held that GST on food provided to employees in the office canteen is not valid as it is a facility provided to the employees and not a service provided for consideration.

8. Commissioner of Central Tax, Delhi vs. Sidhartha Enterprises (2020) (SC)

The court held that GST on reimbursement of expenses cannot be levied as it does not involve any consideration.

9. Indian Oil Corporation Ltd. vs. Commissioner of Commercial Taxes (2020) (SC)

In this case, the court held that GST on freight charges cannot be levied if the recipient of the goods is the one who arranges for the transportation.

COMPLIANCE CALENDAR APRIL 2023

| Return / Forms | Month/Year | Due/Ext. Dt. | Remark |
|---|-------------------------|--------------|---|
| Deposit of TDS/TCS | - | 07-04-2023 | By an Office of Government |
| GSTR – 7 | March – 2023 | 10-04-2023 | TDS Deductor |
| GSTR – 8 | March – 2023 | 10-04-2023 | E- commerce operator |
| GSTR - 1 (Monthly) | March – 2023 | 11-04-2023 | RP having ATO > Rs. 5Cr or opted for monthly filing |
| GSTR – 1 (QRMP) | January – March 2023 | 13-04-2023 | RP having ATO upto Rs. 5 Cr |
| GSTR – 6 | March – 2023 | 13-04-2023 | ISD Return |
| TDS Certificate | March – 2023 | 13-04-2023 | Issue of TDS Certificate U/s 194-IA, 194-IB, 194M and 194S. |
| Form 16B, 16C, 16D and 16A respectively | February' - 2023 | 14-04-2023 | Furnishing statement in Form no. 3BB by a stock exchange in respect of tran been modified after registering in the month. |
| PF and ESIC | March – 2023 | 15-04-2023 | PF and ESIC Contribution to Government |
| CMP - 08 | January – March 2023 | 18-04-2023 | CMP-08 is for payment of self-assessed tax liability to be filed quarterly by co |
| GSTR – 3B (Monthly) | March – 2023 | 20-04-2023 | RP having ATO > Rs. 5Cr or opted for monthly filing |
| GSTR - 5A | March – 2023 | 20-04-2023 | OIDAR Service Providers |
| GSTR – 5 | March – 2023 | 20-04-2023 | Non-Resident taxable Person |
| GSTR – 3B (QRMP) | January – March 2023 | 22-04-2023 | RP having ATO upto Rs. 5 Cr |
| Deposit of TDS/TCS | March – 2023 | 30-04-2023 | Other than Government office |
| Form 15G/15H | 2022-2023 | 30-04-2023 | Uploading of Form 15G/15H received during the quarter ending March 2023. |
| Deposit of TDS/TCS | January – March 2023 | 30-04-2023 | Quarterly deposit of TDS for Q4 when AO has permitted quarterly deposit of TDS U/s 192, 194A, 194D or 194H. |
| MSME- Half Yearly Return | October- March 2023 | 30-04-2023 | A half-yearly return with the registrar for outstanding payments to Micro or Small Enterprises. |



NATIONAL CONFERENCE ON BANK AUDIT 25-26 March, 2023





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