

Adukia & Associates
Chartered Accountants

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INFORMATION SYSTEM AUDIT

Preface

**“The only important thing in a book is the meaning that it has for you”
W. Somerset Maugham**

ASSOCHAM (Associated Chamber of Commerce Industries) Study on Start-Ups released on 2 August 2015 pointed out that India is expected to produce at least a score of billionaires and many times millionaires among the start-ups in the next five years. These billionaires and millionaires will be created through e-commerce, financial services and other technology driven fields generating the maximum interest.

The paper said that India will be among the top Asian start-ups along with the Chinese and the South East countries. However, the structural problems in China are likely to create road blocks for the start-ups there. No such issue confronts the Indian start-ups.

India Ratings and Research said in a research report that Indian economic growth will overtake China's in 2015 if there is continuous policy intervention from the government.

The report further said that if the current policy initiatives and efforts of the government are sustained, the Indian economy will gradually return to a higher growth trajectory over two-to-three year period. An economic slowdown in China will help India overtake the former in economic growth.

The research report said that recent economic developments in China are bigger issues/concerns for the Indian economy than the Greece issue. The China economy slowdown can bring in both good and bad news for India as exports could be affected due to slower global growth, but lower commodity prices can provide some support.

Major boost is expected in e-commerce, music-entertainment, payment gateways and city transport aggregators like radio taxis. Within e-commerce, a lot more varieties are expected to create.

Good news is that industry leaders like Ratan Tata, Azim Premji and NR Narayan Murthy are entering the Angel Investor's space. Their presence would certainly have a moral pressure among the entrepreneurs who would like to prove their mettle rather than make quick bucks.

In this edition we are discussing about Information System Audit, Fraud Prevention, New changes in ITR form, Capitalisation of Bank finance, Highlights of GST, Ind AS - 101, recent notifications, case laws and statutory payment schedule for the month of August, 2015.

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What is Information System Audit (ISA)

An Information system audit also referred as Electronic Data Processing Audit (EDP), Automated Data Processing Audit (ADP) and Information Technology Audit is an examination of management controls or system controls within an information technology infrastructure. It is the process of evaluating the suitability and validity of an organization's IT configurations, practices and operations.

Computers and electronic devices are part of our lifestyle and we are living in the world of Apps. Emerging use of computers and other electronic devices compelled to maintain and control the data in those systems more secure. The misuse of data can lead to misallocated resources, abuse of privacy can occur with uncontrolled distribution of data. Electronic infrastructure and commerce are integrated in business processes around the globe. The need to control and audit IT has never been greater.

Foundations of ISA

- Information system management
- Computer science
- Behavioral science
- Traditional auditing

IT auditing is an integral part of the audit function because it supports the auditor's judgment on the quality of the information processed by computer systems. Initially, auditors with IT audit skills are viewed

as the technological resource for the audit staff. The audit staff often looked to them for technical assistance. There are many types of audit needs within IT auditing, such as organizational IT audits (management control over IT), technical IT audits (infrastructure, data centers, data communication), application IT audit (business/financial/operational), development/implementation IT audits (specification/requirements, design, development, and post-implementation phases), and compliance IT audits involving national or international standards. The IT auditor's role has evolved to provide assurance that adequate and appropriate controls are in place. Of course, the responsibility for ensuring that adequate internal controls are in place rests with the management. The audit's primary role, except in areas of management advisory services, is to provide a statement of assurance as to whether adequate and reliable internal controls are in place and are operating in an efficient and effective manner. Therefore, whereas management is to ensure, auditors are to assure.

The breadth and depth of knowledge required to audit IT systems are extensive. For example, IT auditing involves the

- Application of risk-oriented audit approaches
- Use of computer-assisted audit tools and techniques
- Application of standards (national or international) such as ISO 9000/3 and ISO 17799 to improve and implement quality systems in software development and meet security standards
- Understanding of business roles and expectations in the auditing of systems under development as well as the purchase of software packaging and project management
- Evaluation of complex systems development life cycles (SDLC) or new development techniques; e.g., prototyping, end user computing, rapid systems, or application development

- Reporting to management and performing a follow-up review to ensure actions taken at work

The auditing of complex technologies and communications protocols involves the Internet, intranet, extranet, electronic data interchange, client servers, local and wide area networks, data communications, telecommunications, wireless technology, and integrated voice/data/video systems.

There are three types of information system audits: audit carried out in support of a financial statements audit, audit to evaluate compliance to applicable laws, policies and standards related to IT, and finally an IT audit can also be a performance (or value-for-money) audit. The objectives of this audit include finding out if there are any excesses, inefficiency and wastage in the use and management of IT systems. This audit is carried out to assure the stakeholders that the IT system in place is value for the money invested in it.

The general steps followed during an IT audit are establishing the objectives and scope, developing an audit plan to achieve the objectives, gathering information on the relevant IT controls and evaluating them (groundwork), carrying out testing, and finally reporting on the findings of the audit. Additionally, there may be a follow-up step to find out if any recommendations by the audit team have been implemented as well as to address any arising issues.

Audit Risks

Auditors are concerned with four objectives:

- Asset safeguards
- Data integrity
- System effectiveness
- System efficiency

One of the key things of auditing is to identify whether errors and irregularities will cause material losses.

Auditing might also assess whether the processes followed have contributed or are contributing to any ongoing losses. To assess this, auditor need to collect evidence. Auditors might not detect real or potential losses due to the test nature of the audit. A basis for determining the desired level of risk the use of the following model is of some significance.

$DAR = IR \times CR \times DR$, where DAR is the desired audit risk, IR is the inherent risk, CR is the control risk and DR is the detection risk.

The basic areas of an IT audit scope can be summarized as:

- The organization policy and standards
- The organization and management of computer facilities
- The physical environment in which computers operate
- Contingency planning
- The operation of system software
- The applications system development process
- Review of user applications and end-user access

To summarize, an information systems audit is important because it gives assurance that the IT systems are adequately protected, provide reliable information to users, and are properly managed to achieve their intended benefits. It also reduces the risk data tampering, data loss or leakage, service disruption and poor management of IT systems.





institutions, hundreds of millions of rupees are lost due to fraud every year.

The fraud prevention strategy outlines a high level plan on how the Institution will go about implementing its fraud prevention policy. The strategy forms the most important part of the fraud prevention plan therefore it must be uncomplicated and practical. Therefore, it becomes vital for every organization whether it is large or small, to have fraud prevention plan in place.

Introduction:

Fraud is an abuse of position, or false representation, or prejudicing someone's rights for personal gain. Fraud is having widest possible meaning and is intended to include all aspects of economic crime and acts of dishonesty.

Laws are passed, agencies are established, police are hired, ethics and morals are taught in schools and learned in businesses, and criminals are punished by the forfeiture of their ill-gotten gains and personal liberty—all with a view to deterring, detecting, and punishing fraud. One of the central outcomes of fraud is financial loss. Therefore, in the minds of the investing public, the accounting and auditing profession is linked with fraud deterrence, fraud detection, and fraud investigation. This is true to such an extent that there are those whose perception of what can be realistically accomplished in an audit frequently exceeds the services that any accountant or auditor can deliver and, in terms of cost, exceeds what any business might be willing to pay.

Fraud prevention is a topic applicable to many industries including banking and financial sectors, insurance, government agencies and law enforcement, and more. Fraud attempts have seen a drastic increase in recent years, making fraud prevention more important than ever. Despite efforts on the part of the

How to prevent fraud:

- **Set standards**

One of the best ways to safeguard a business is to set clear standards. An employee manual can be helpful in establishing the principles and values to guide the organization. In a small organization, an employee manual levels the playing field and keeps the rules from becoming subjective. If someone is dismissed, the manual can be a reference that explains the action taken by the organization.

- **Effective Internal Controls**

Internal controls are the plans and programs implemented to safeguard organization's assets, ensure the integrity of its accounting records, and deter and detect fraud and theft.

Segregation of duties is an important component of internal control that can reduce the risk of fraud from occurring. For example, a retail store has one cash register employee, one salesperson, and one manager. The cash and cheque register receipts should be tallied by one employee while another prepares the deposit slip and the third brings the deposit to the bank. This can help to reveal any discrepancies in the collections.

According to the Committee of Sponsoring Organizations (COSO), Internal control is broadly defined as a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- effectiveness and efficiency of operations,
- reliability of financial reporting
- compliance with applicable laws and regulations

Internal controls are a dynamic and fluid set of tools which evolve over time as the business, technology and fraud environment changes in response to competition, industry practices, legislation, regulation and current economic conditions. Strengthening internal controls is accomplished by enhancing one process, rather it involves a comprehensive review of the risks faced, the existing internal controls and their adequacy in preventing fraud from occurring.

Internal control programs should be monitored and revised on a consistent basis to ensure they are effective and current with technological and other advances. If organization does not have an internal control process or fraud prevention program in place, then one can hire a professional with experience in this area. An expert will analyze the company's policies and procedures, recommend appropriate programs and assist with implementation.

- **Monitoring Employees:**

At the beginning, when any organization is hiring new employees, it should thoroughly check references and perform background checks that include employment, credit, licensing and criminal history. Secondly organization must know their employees by observing and listening to employees can help them to identify potential fraudsters. It is important for management to

be involved with their employees and take time to get to know them.

Often, an attitude change of employees can ignite a risk. Any attitude change should cause management to pay close attention to that employee. This may not only minimize a loss from fraud, but can make the organization a better, more efficient place with happier employees.

Management might be impressed by the employees who haven't missed a day of work in years. While these may sound like loyal employees, it could be a sign that these employees have something to hide and are worried that someone will detect their fraud if they were out of the office for a period of time. It is always a good idea to rotate employees to various jobs within an organization. This may also reveal fraudulent activity as it allows a second employee to review the activities of the first.

Every employee within the organization should be aware of the fraud risk policy including types of fraud and the consequences associated with them. Those who are planning to commit fraud will know that management is watching and will hopefully be deterred by this. Honest employees who are not tempted to commit fraud will also be made aware of possible signs of fraud or theft. These employees may prove to be asset in the fight against fraud.

- **Independent assessment of books of accounts**

All account reconciliations and general ledger balances should be reviewed, as theft often occurs when bookkeeping is disarranged and unsupervised. Bookkeeping function should be familiar with the record system. This enables spot checks and reviews and provides better assurance that nothing is inaccurate.

- **Annual audits**

Obtaining an annual audit report is a valuable measure towards preventing fraud. An audit report may not discover all fraud within an organization, but it will give an opportunity to have a “bird’s eye view” of the business. An audit also tends to motivate all bookkeeping-related staff to keep things honest because they can never be sure what questions an auditor is going to ask or what documents an auditor may request to review.

Inference:

One cannot deny the omnipresence of fraudster in an organization. It can happen in large or small companies across various industries and geographic locations. Fraud can result in huge financial loss, legal costs, and ruined reputations that can ultimately lead to the downfall of an organization. Having the proper plans in place can significantly reduce fraudulent activities from occurring. Making the company policy known to employees is one of the best ways to deter fraudulent behavior. The cost of trying to prevent fraud is less expensive to a business than the cost of the fraud that gets committed.

HIGHLIGHTS OF KEY CHANGES IN NEW ITR FORMS - 3, 4, 5, 6 AND 7



The new ITR Forms 1, 2 and 4S were notified for the Assessment Year 2015-16 vide Notification No. 41/2015, Dated 15-04-2015. However, in view of representations received from various stakeholders, the CBDT came out with simplified version of ITR forms 1, 2, 2A and 4S.

Now the CBDT has notified the remaining ITR forms, viz, ITR Forms 3, 4, 5, 6 and 7 vide Notification No. 61/2015. Key changes in ITR forms is highlighted below.

1) Expenditure on CSR activities:

Section 37(1) was amended by the Finance (No. 2) Act, 2014 to provide that any expenditure incurred by an assessee on the activities relating to corporate social responsibility (CSR) shall not be allowed as deduction as same could not be considered to be incurred for the purposes of the business or profession. Accordingly, ITR 6 has been revised to provide for reporting of ex-

penditure on CSR activities if the same is debited to profit and loss account.

2) Foreign portfolio investors/Foreign Institutional investors:

Foreign Institutional Investor (FII) and Foreign Portfolio Investor (FPI) are required to furnish their SEBI registration number in the new ITR 5 and 6.

3) Bank accounts held by assessee:

In old return forms taxpayers are required to give details of only one bank account. Now in new return forms taxpayer are required to report details of all bank accounts except dormant accounts.

4) Change in partners/members:

A new column has been inserted in ITR-5 to require the assessee to furnish the details of change in the partners/members of the firm/AOP/BOI, as the case may be, during the previous year.

5) Aadhaar Number and passport number:

Aadhaar number and passport number are required to be given in new ITR 3 and 4 (if assessee has obtained the same).

INDIAN BANKS NEED TO BE CAPITALISED!



What is the best investment choice for the ordinary investor?

There is palpable disappointment when the answer is: there is no such choice. Everything is risky from taking the road to choosing a partner. Risk, return and diversification are fundamental ideas that each investor has to learn, without protesting about entitlements. There is nothing like risk-free asset. But the good news is that financial structures can be created to come close to that ideal. Consider the much coveted bank deposit. Many of us trust the bank; there is little reason why we should not. The structure of a bank has been honed over years to protect depositors. This despite the fact that the bank uses the depositors' money to make risky loans.

“Indian Banks need to be capitalized!”

A bank cannot simply take deposits and make loans. It has to back its promise to its depositors with a solid balance sheet structure. There are four primary ingredients that make a bank deposit nice and robust investment product.

First, a bank cannot fund all its loans with deposits. It has to have its own capital. For example, if a bank wants to have a loan book of Rs.100, it can raise Rs.90 as deposits but, to do so, it must first raise Rs.10 as equity capital. The equity capital has to be adequate to cover the risks of the loans. What does this mean? If Rs.10 is equity capital and Rs.100 has been lent out,

the bank has allowed for a risk of Rs.10 on its loans or even if 10% of its loans go bad, it can still repay Rs.90 to its depositors. When we speak of capital adequacy norms, we refer to the regulatory requirement, which weighs the loans based on each category's risk, and asks the bank to first raise equity capital, to provide the cushion, so that depositors are protected. This is why, when banks' nonperforming assets (NPAs) go up, we now talk of banks' need to be 'capitalised'.

Second, a part of the deposits is kept as cash with the central bank, to meet exigencies. Third, a part of assets have to be statutorily kept in safer government securities, only the rest can be lent as risky loan. Lastly, if a bank finds that its loans have gone bad, it has to provide for them from its profits. All these ingredients make the bank's balance sheet a dependable structure for investors who deposit money, earn the stated interest, and access it when they like.

Hoping to earn a high return, in its quest to maximize profits, a bank may give very risky loans. The bank may be reckless in its lending practices, making loans to poor quality borrowers. The primary risk of all these events impacts the equity investor. In our example, if the loan book falls in value from Rs.100 to Rs.92, the deposit holder will still get back Rs.90. But the equity investors' value has eroded from Rs.10 to Rs.2. If the bank hides its bad loans, or fails to provide, or does not get more equity capital to support the risky assets, it could default on its deposits too. This is why equity is riskier than debt. But not all promises made by a borrower to a lender are good. It all depends on the quality of the assets and the structure of the balance sheet. If one bank has low NPAs and good equity value, it is qualitatively better than another bank with high NPAs and low and falling equity values. Many who assume that nothing can go wrong with PSU banks are not guided by the principles of finance, but by the blind faith that the government will not allow the banks to fail.

When a bank is stressed by bad loans, it needs equity capital- to make new loans and to price and service its depositors competitively. A bank with a weak balance sheet will have to pay more for deposits. It has to make riskier loans to make profits. Therefore, a weak bank is not a great place to be in. If the government has to step in, it has to find money to be an equity investor in the weak bank, or fund other equity investors. Both tasks are tough.

What about other investments? In each case, the structure is what matters. In a company deposit, the asset of the company matters. If it is a profitable business, and if it is adequately capitalised, it might be a good investment option. In a PSU, or any other company bond, the same principle works. In any debt investment, investors should take the time to see what is at work to protect their money. As a rule, lending to a business whose equity share prices are failing is bad idea. The risk of the assets is what the equity prices reflect.

How about equity? An equity investor is directly exposed to the risk of the assets. The only protection to the equity investor is diversification. All assets don't go bad at the same time. If an equity investor's shares are spread across different businesses, the risk of failure will be lower. For example, an investor holding PSU bank stocks and private banking stocks, might be better off than one holding only PSU bank stocks.. An investor holding banking, pharma and IT stocks might fare even better. But the risk cannot be eliminated completely.

So, what does taking charge mean? Three key things. First, there is no guarantee in modern finance. A promise about return is as good as the balance sheet on the basis of which it is made. Second, diversification is the key to reducing risks arising from promises gone weak or bad. Third, there is no point trying to forecast the future. Even the best loans can fail, and

great companies can fall. To invest means accepting that returns will always come with risks, and that diversification is more sensible than mindless speculation about the future.

What are non –performing assets?

As per RBI guidelines, NPA is defined as under:

Non -performing asset (NPA) is a loan or an advance where:

- interest and/ or installment of principal remain overdue for a period of more than 90 days in respect of a term loan,
- the account remains 'out of order' in respect of an Overdraft/Cash Credit (OD/CC),
- the bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted

*Any amount due to the bank under any credit facility, if not paid by the due date fixed by the bank becomes overdue.

What does “out of order” mean?

An account should be treated as 'out of order' if the outstanding balance remains continuously in excess of the sanctioned limit / drawing power. In cases where the outstanding balance in the principal operating account is less than the sanctioned limit / drawing power, but there are no credits continuously for 90 days or credits are not enough to cover the interest debited during the same period, these accounts should be treated as 'out of order'.

Inference: What does “no credits” mean? In case of businesses availing the facility of CC, which is generally against hypothecation of stock and debtors, assuming the outstanding balance is less than sanctioned limit or drawing power then if the company is not routing its sales through it CC bank account for continuously 90 days or that amount is not equivalent to interest debited by bank during the same period, then this account shall be treated as out of order

Let's get deeper now:**What really happens if a loan goes bad?**

As soon as an account is reported as NPA, lenders form a lenders' committee to be called as Joint Lenders' Forum (JLF) under a convener and formulate a joint corrective plan (CAP) for early resolution of stress in the account. The intention of this Framework is not to encourage a particular resolution option, e.g. restructuring or recovery, but to arrive at an early and feasible resolution to preserve the economic value of the underlying assets as well as the lenders' loans. The options under Corrective Action Plan (CAP) by the JLF would generally include:

(a) Rectification - Obtaining a specific commitment from the borrower with identifiable cash flows within the required time to regularise the account so that the account does not slip into the NPA category, within a specific time period acceptable to the JLF without involving any loss or sacrifice on the part of the existing lenders. If the existing promoters are not in a position to bring in additional money or take any measures to regularise the account, the possibility of getting some other equity/strategic investors to the company may be explored by the JLF in consultation with the borrower. These measures are intended to turn-around the company without any change in terms and conditions of the loan. JLF may also consider providing need based additional finance to the borrower, if considered necessary, as part of the rectification process. However, it should be strictly ensured that additional financing is not provided with a view to evergreen* the account.

*There is an established practice in almost all co-operative banks to keep the loan account EVER-GREEN. To illustrate and to make it more clear : say a bank disburse a loan of Rs.10000 to a farmer and the

account become overdue after a year or two , the same bank sanction a loan of Rs.20000 or Rs.30000 which enable farmer to repay first loan and avail only extra loan . In the same way bank use to sanction inflated loan year after year, this keeps the account always standard. During the course of time, public sector banks have also learnt the art of keeping the loan account evergreen. Under evergreening, banks provide additional loans to stressed borrowers, often indirectly, to enable them to repay existing loans that can keep a loan from going sour, but it ratchets up a bank's exposure to a troubled credit and the odds, in most cases, are against it.

(b) Restructuring - Consider the possibility of restructuring the account if it is prima facie viable and the borrower is not a wilful defaulter, i.e., there is no diversion of funds or fraud etc. At this stage, commitment from promoters for extending their personal guarantees along with their net worth statement supported by copies of legal titles to assets may be obtained along with a declaration that they would not undertake any transaction that would alienate assets without the permission of the JLF. Any deviation from the commitment by the borrowers affecting the security/recoverability of the loans may be treated as a valid factor for initiating recovery process.



Let's consider an example here:

Assume a company with the below stated financial parameters:

	2012-13	2013-14	2014-15	Total
				(Rs. in Cr.)
Net Sales	150	170	160	480
EBITDA	45	50	53	148
Less: Normal CAPEX	-3.3	-3.5	-3.5	-10.3
Cash flow available for debt servicing	41.7	46.5	49.5	137.7
Debt servicing requirements	117	125	118	360
Repayment as per existing schedule	62	80	84	226
Interest	55	45	34	134
Cash Gap	-75.3	-78.5	-68.5	-222.3
Cumulative Cash Gap	-75.3	-153.8	-222.3	

Since the existing debt schedule indicates peak cash flow gap of Rs. 222.30 crore, it is clearly unsustainable and so the company may decide to restructure their loans.

Next question is why a bank will agree for restructuring?

Restructuring typically entails extending tenure on the loan, easing interest rates or even converting debt to equity.

Consider a bank has sanctioned Rs150 Crore Term Loan to a company.

RBI has directed the banks to make provisions or set aside money when the account turns bad.

Sr. No	Classification	Provisioning Requirements
1	Standard	0.40%
2	Sub-Standard Asset /NPA	Secured 15% Unsecured 25%
3	Doubtful Asset (Asset remains NPA for 12 months or more)	
a	Upto 1 year	Secured 25% Unsecured 100%
b	1 - 3 years	Secured 40% Unsecured 100%
c	More than 3 years	Secured 100% Unsecured 100%
4	Loss Asset	100%

Now, assume of Rs.150 crore, Rs.100 Crore term Loan is outstanding against security currently fetching market value of Rs. 80 Crore. Rs.20 Crore is unsecured portion for the bank. Now, if the loan account turns NPA/ slips to sub-standard category, bank has to provide in its books/ profit & loss account – Provision for bad or doubtful debt of Rs.12 Cr (15% on Rs.80 Crore) & Rs. 5 Cr. (25% on Rs.20 Crore).

If bank opts for restructuring, it will extend the tenure of the loan and will ease the interest rate on the loan. This will call for the bank to make provision in its books / provide for loss on account for diminution in fair value of the asset or loan.

Pre – Restructuring Cash flows

Year	Principal Repayment	Outstanding Balance	Interest Payment	Total Cash Outflow
			Rate Of Interest – 14%	
		100		
1	20	80	14.00	34.00
2	20	60	11.20	31.20
3	20	40	8.40	28.40
4	20	20	5.60	25.60
5	20	0	2.80	22.80
			Total Outflow	142.00
			Original NPV	95.69

Post- Restructuring Cash flows

Year	Principal Repayment	Outstanding Balance	Interest Payment	Total Cash Outflow
			Revised Rate of Interest -12%	
		100		
1	10	90	12	22
2	10	80	10.8	20.8
3	10	70	9.6	19.6
4	10	60	8.4	18.4
5	10	50	7.2	17.2
6	10	40	6	16
7	10	30	4.8	14.8
8	10	20	3.6	13.6
9	10	10	2.4	12.4
10	10	0	1.2	11.2
			Total Outflow	166
			Revised NPV	87.08

In the above cash flows, we entail revision in interest rate i.e. 14% to 12% and extension of loan tenor i.e. 5 year to 10 year. The erosion in the fair value of the advance should be computed as the difference between the fair value of the loan before and after restructuring. Fair value of the loan before restructuring will be computed as the present value of cash flows representing the interest at the existing rate charged on the advance before restructuring and the principal, discounted at a rate equal to the bank's BPLR or base rate (whichever is applicable to the borrower) as on the date of restructuring plus the appropriate term premium and credit risk premium for the borrower category on the date of restructuring. Fair value of the loan after restructuring will be computed as the present value of cash flows representing the interest at the rate charged on the advance on restructuring and the principal, discounted at a rate equal to the bank's BPLR or base rate (whichever is applicable to the borrower) as on the date of restructuring plus the appropriate term premium and credit risk premium for the borrower category on the date of restructuring.

As we see above, the difference in NPV of Rs. 8.60 Cr (95.69 – 87.08) is called the sacrifice done by the lender to restructure borrower's loan and it is the amount bank needs to provide on account on diminution in fair value of the asset . RBI stipulates banks to also provide 5% of O/s amount i.e (100 * 5%) in their books for keeping the account under category "standard restructured asset". Hence, the total provisioning shall be Rs.13.60 Cr (8.60+ 5) as against Rs.17 Cr if the bank had not restructured the loan.

Is it that all the companys' under stress can get their debt restructured?

No. Below are the cases where banks will not agree to restructure borrowers' debt

- Where there is diversion of funds which includes

any one of the under noted occurrences:

- (a) utilisation of short-term working capital funds for long-term purposes not in conformity with the terms of sanction;
- (b) deploying borrowed funds for purposes / activities or creation of assets other than those for which the loan was sanctioned;
- (c) transferring funds to the subsidiaries / Group companies or other corporates by whatever modalities;
- (d) routing of funds through any bank other than the lender bank or members of consortium without prior permission of the lender;
- (e) investment in other companies by way of acquiring equities / debt instruments without approval of lenders;
- (f) shortfall in deployment of funds vis-à-vis the amounts disbursed / drawn and the difference not being accounted for.

- Where there is Siphoning of funds, which is construed to occur if any funds borrowed from banks / FIs are utilised for purposes un-related to the operations of the borrower, to the detriment of the financial health of the entity or of the lender. The decision as to whether a particular instance amounts to siphoning of funds would have to be a judgement of the lenders based on objective facts and circumstances of the case.
- The identification of the wilful default should be made keeping in view the track record of the borrowers and should not be decided on the basis of isolated transactions/incidents. The default to be categorised as wilful must be intentional, deliberate and calculated.

(c) Recovery - Once the first two options at (a) and (b) above are seen as not feasible, due recovery process may be resorted to. The JLF may decide the best recovery process to be followed among the various legal and other recovery options available with a view to optimising the efforts and results.

Inference : The problem is that many such loans are never recovered ,adding to the challenge of collecting on bad loans in a country where there is no bankruptcy law - the absence of which makes banks more inclined to help borrowers rather than declare a loan to be in default and receive nothing.

End-use of Funds

In cases of project financing, the banks / FIs seek to ensure end use of funds by, inter alia, obtaining certification from the Chartered Accountants. The banks and FIs, should not depend entirely on the certificates issued by the Chartered Accountants but strengthen

their internal controls and the credit risk management system to enhance the quality of their loan portfolio. Some of the illustrative measures that could be taken by the lenders for monitoring and ensuring end-use of funds:

- (a) Meaningful scrutiny of quarterly progress reports / operating statements / balance sheets of the borrowers;
- (b) Regular inspection of borrowers' assets charged to the lenders as security;
- (c) Periodical scrutiny of borrowers' books of accounts and the no-lien accounts maintained with other banks;
- (d) Periodical visits to the assisted units;
- (e) System of periodical stock audit, in case of working capital finance;
- (f) Periodical comprehensive management audit of the 'Credit' function of the lenders, so as to identify the systemic-weaknesses in the credit-administration.

(It may be kept in mind that this list of measures is only illustrative and by no means exhaustive.)

Electronic Verification Code (EVC) to e-verify Income Tax Returns

Government has come out with the Electronic Verification Code for verifying the income tax return to make the e-filing process completely paperless. Now, you just have to put an EVC after filing your return and you are done with e-filing, no need to send signed ITR-V to CPC, Bangalore within 120 days' time frame.

What is Electronic Verification Code (EVC)

Electronic Verification Code (EVC) is a 10 digits alpha numeric code to verify your income tax return and can be generated via various methods.

- EVC is a 10 digit alpha numeric code which would verify the identity of the person filing the income tax return.
- The EVC could be used to verify ITR 1 (Sahaj) / ITR 2 / ITR 2A / ITR 3 / ITR 4 / ITR 4S (Sugam).
- EVC would be unique and can be used only with the

PAN of the person furnishing the income tax return. This means one EVC for one PAN.

- One EVC can be used to validate only one ITR whether it is original or revised return.
- The EVC remains valid for 72 hours but can be generated various times through various modes.
- In case the tax returns are already filed or uploaded, the verification needs to be done within 120 days of filing of return.

How to Generate Electronic Verification Code (EVC)

- Generate EVC through e-filing website
- Generate EVC through Linking Aadhaar Card with PAN
- Generate EVC through Bank ATM (Automatic Teller Machine)

HIGHLIGHTS OF REPORT OF 'RAJYA SABHA PANEL' ON GST BILL



The Bill empowered GST Council to make recommendations for the rates of goods and service tax including floor rates with bands. The Committee recommended that the word 'band' may be defined in GST laws as following:

"Band": Range of GST rates over the floor rate within which Central Goods and Service Tax (CGST) or State Goods and Service Tax (SGST) may be levied on any specified goods or services or any specified class of goods or services by the Central or a particular State Government as the case may be.

In its report, The Committee mentioned that it was aware that while discharging the functions conferred upon the GST Council, it would be guided by the need for a harmonized structure of goods and services tax and for the development of a harmonized national market for goods and services.

It can be said that while construing above definition of 'Band' one has to ensure that harmonized structure of GST-rates must not be altered.

"Voting pattern": The Committee found no merit in altering the voting pattern proposed in the Bill.

"Dispute Settlement Authority": It also didn't recommend inclusion of provision for GST Dispute Settlement Authority having noted that GST Council shall decide only the 'modalities' to resolve disputes.

Definition of 'Supply': The Bill proposed definition of 'goods and services tax' to mean any tax on supply of goods, or services or both. The Committee opined that the term 'supply' would be defined in the various GST laws relating to CGST and SGST, therefore, it would not be appropriate to define the term 'supply' in the Bill.

Definition of 'services': The Bill proposed to define 'services' to mean anything other than goods. The Committee felt that term 'services' had been so defined in order to give it wide amplitude so that all supplies that are not goods can broadly be covered within the ambit of services and no activity remains outside the taxable net. It also opined that this would also minimize disputes. In view of the above, it proposed no change in the definition.

Additional Goods and Services Tax: The Bill proposed to levy non-Cenvatable additional tax at 1% on inter-State supply of goods. The Committee felt that the provision of 1% additional tax in its present form was likely to lead to cascading effect of taxes. Therefore, it strongly recommended that following Explanation should be added for word 'supply':

Supply: "All forms of supply made for a consideration."

Compensation to States: The Bill proposed that the Parliament 'may' compensate States for loss of revenue for a period which may be extended to five years. The Committee felt that there was no justification for substitution of the word 'may' with 'shall'. It, however, recommended that compensation should be provided for whole period of five years.

FIRST-TIME ADOPTION OF INDIAN ACCOUNTING STANDARDS (IND AS 101)



An entity's first Ind AS financial statements are the first annual financial statements in which the entity adopts Ind AS, in accordance with Ind AS notified under the Companies Act, 2013 and makes an explicit and unreserved statement in those financial statements of compliance with Ind AS.

Recognition and measurement Opening Ind AS Balance Sheet

An entity shall prepare and present an opening Ind AS Balance Sheet at the date of transition to Ind AS.

Accounting policies

An entity shall use the same accounting policies in its opening Ind AS Balance Sheet and throughout all periods presented in its first Ind AS financial statements. Those accounting policies shall comply with each Ind AS effective at the end of its first Ind AS reporting period

The transitional provisions in other Ind AS apply to changes in accounting policies made by an entity that already uses Ind AS; they do not apply to a first-time adopter's transition to Ind AS

An entity shall apply the following exceptions:

(a) derecognition of financial assets and financial liabilities; (b) hedge accounting; (c) non-controlling in-

terests; (d) classification and measurement of financial assets; (e) impairment of financial assets; (f) embedded derivatives and (g) government loans.

Estimates

An entity's estimates in accordance with Ind AS at the date of transition to Ind AS shall be consistent with estimates made for the same date in accordance with previous GAAP (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those estimates were in error.

Comparative information

An entity's first Ind AS financial statements shall include at least three Balance Sheet, two Statements of profit and loss, two Statements of cash flows and two Statements of changes in equity and related notes, including comparative information for all statements presented.

Transition to Ind AS

An entity shall explain how the transition from previous GAAP to Ind AS affected its reported Balance sheet, financial performance and cash flows. This mainly includes reconciliation of items disclosed in GAAP and in Ind AS of the date of transition to Ind AS

Designation of financial assets or financial liabilities

An entity is allowed to designate a previously recognized financial assets and liabilities at fair value through profit and loss account. The entity shall disclose the fair value of financial assets and liabilities so designated at the date of designation and their classification and carrying amount in the previous financial statements.

Interim financial reports

- if an entity presents an interim financial report in accordance with Ind AS 34, it should satisfy the following requirement in addition to the requirements of Ind AS 34
- a) Each such interim financial report shall, if the entity presented an interim financial report for the comparable interim period of the immediately preceding financial year include reconciliation of items disclosed in GAAP and in Ind AS of the date of transition to Ind AS like;
- (i) a reconciliation of its equity in accordance with previous GAAP at the end of that comparable interim period to its equity under Ind AS at that date; and
 - (ii) a reconciliation to its total comprehensive income in accordance with Ind AS for that comparable interim period (current and year

to date). The starting point for that reconciliation shall be total comprehensive income in accordance with previous GAAP for that period or, if an entity did not report such a total, profit or loss in accordance with previous GAAP.

Ind AS 34 requires minimum disclosures, which are based on the assumption that users of the interim financial report also have access to the most recent annual financial statements. However, Ind AS 34 also requires an entity to disclose 'any events or transactions that are material to an understanding of the current interim period'. Therefore, if a first-time adopter did not, in its 9 most recent annual financial statements in accordance with previous GAAP, disclose information material to an understanding of the current interim period, its interim financial report shall disclose that information or include a cross-reference to another published document that includes it.

AREAS WHERE THE CSR FUNDS HAS TO BE SPENT

- i. Eradicating hunger, poverty and malnutrition, promoting preventive health care and sanitation and making available safe drinking water;
- ii. Promoting education, including special education and employment enhancing vocation skills especially among children, women, elderly, and the differently abled and livelihood enhancement projects;
- iii. Promoting gender equality, empowering women, setting up homes and hostels for women and orphans; setting up old age homes, day care centres and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups;
- iv. Ensuring environmental sustainability, ecological balance, protection of flora and fauna, animal welfare, agroforestry, conservation of natural resources and maintaining quality of soil, air and water;
- v. Protection of national heritage, art and culture including restoration of buildings and sites of historical importance and works of art; setting up public libraries; promotion and development of traditional arts and handicrafts;
- vi. Measures for the benefit of armed forces veterans, war widows and their dependents;
- vii. Training to promote rural sports, nationally recognised sports, paralympic sports and Olympic sports;
- viii. Contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government for socio-economic development and relief and welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women;
- ix. Contributions or funds provided to technology incubators located within academic institutions which are approved by the Central Government;
- x. Rural development



Updates on FCRA

Govt cancels registration of 4,470 NGOs

The good times may be over for non-governmental organisations (NGOs) operating in ‘mysterious’ sectors like participatory democracy, advocacy, action research, innovative communication, inclusiveness etc. As per Media Reports the Union government recently canceled registration of 4,470 NGOs in a fresh crackdown which bars them from receiving foreign funds. Earlier, in March, the government had canceled licences of 1,142 NGOs belonging to undivided Andhra Pradesh, under which they get foreign funds, for not filing their annual returns for three consecutive years. The decision to cancel the registration of these entities under the Foreign Contribution Regulation Act has been taken by the Union Home Ministry after examination of their activities that allegedly include non-filing of annual returns and other anomalies.

Updates on FEMA

Issue of ESOP and/or Sweat Equity to persons resident outside India

The Reserve Bank of India (“RBI”) has notified Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000 to prohibit, restrict or regulate, transfer or issue security by a person resident outside India. In furtherance to said regulations, RBI has amended regulations gov-

erning the issue of shares under employees stock options scheme (“ESOP”) to a person resident outside India of the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) (Fourth Amendment) Regulations, 2015 vide Notification No. FEMA.344/2015 RB dated June 11, 2015.

The Key highlights of the amendments

- I. The terms of “ESOP” and “Sweat Equity Shares” have been defined in consonance with the Companies Act, 2013
- II. An Indian company may issue shares employees’ stock option” and/or “sweat equity shares”, to its employees or employees of its joint venture or wholly owned subsidiary abroad who are resident outside India, directly or through a Trust, provided that:
 - the scheme has been drawn in accordance with the Securities Exchange Board of India (SEBI) regulations or the Companies (Share Capital and Debentures) Rules, 2014 notified by the Central Government under the Companies Act 2013, as the case may be
 - The “ESOP/SES” issued to non-resident employees/directors under the applicable rules/regulations are in compliance with the sectoral cap applicable to the said company
 - Prior approval of Foreign Investment Promotion Board (FIPB) of Government of India is required
 - where foreign investment is under the approval route
 - Issue of ESOP/SES to an employee/director who is a citizen of Bangladesh/Pakistan
- III. The issuing company shall furnish a report/return as per the Form-ESOP to the RBI within 30 days from the date of issue of employees’ stock option or sweat equity shares

Other Updates

Prior RBI Approval is required in Cases of Acquisition/ Transfer of Control of NBFCs

As per circular No. RBI/2015-16/122 dated July 9, 2015, RBI has revised the directions for acquisition or transfer of control of Non-Banking Finance Companies.

A. Requirement of prior approval of Reserve Bank

Prior written permission of the Reserve Bank shall be required for:

- any takeover or acquisition of control of an NBFC, which may or may not result in change of management;
- any change in the shareholding of an NBFC, including progressive increases over time, which would result in acquisition/ transfer of **shareholding of 26 per cent or more of the paid up equity** capital of the NBFC. Prior approval would, however, not be required in case of any shareholding going beyond 26% due to buyback of shares/ reduction in capital where it has approval of a competent Court. The same is however required to be reported to the Reserve Bank not later than one month from its occurrence
- any change in the management of the NBFC which would result in change **in more than 30 per cent of the directors**, excluding independent directors. Prior approval would not be required for those directors who get re-elected on retirement by rotation.

Notwithstanding clause (A), NBFCs shall continue to inform the Reserve Bank regarding any change in their directors/ management as required

B. Application for prior approval

- (i) NBFCs shall submit **an application, in the company letter head**, for obtaining prior approval of the Bank under paragraph 2, along with the following documents:

- Information about the proposed directors/ shareholders as per the Annex;
- Sources of funds of the proposed shareholders acquiring the shares in the NBFC;
- Declaration by the proposed directors/ shareholders that they are not associated with any unincorporated body that is accepting deposits;
- Declaration by the proposed directors/ shareholders that they are not associated with any company, the application for Certificate of Registration (CoR) of which has been rejected by the Reserve Bank;
- Declaration by the proposed directors/ shareholders that there is no criminal case, including for offence under section 138 of the Negotiable Instruments Act, against them; and
- Bankers' Report on the proposed directors/ shareholders.
- (ii) Applications in this regard may be submitted to the Regional Office of the Department of Non-Banking Supervision in whose jurisdiction the Registered Office of the NBFC is located.

C. Requirement of Prior Public Notice about change in control/ management

- A public notice of **at least 30 days** shall be given before effecting the sale of, or transfer of the ownership by sale of shares, or transfer of control, whether with or without sale of shares.
- The public notice shall indicate the intention to sell or transfer ownership/ control, the particulars of transferee and the reasons for such sale or transfer of ownership/ control.
- The notice shall be published in at least one leading national and in one leading local (covering the place of registered office) vernacular newspaper.

D. The directions contained above are applicable with immediate effect

E. Any violation of the aforementioned directions would result in adverse regulatory action including cancellation of CoR.



Direct Tax

CIT vs. DLF Commercial Project Corp (Delhi High Court)

S. 40(a)(ia): The obligation to deduct TDS is only with respect to "income". As amounts paid as "reimbursement of expenses" do not have the character of income, there is no obligation to deduct TDS

Section 194C (TDS for "work") and Section 194J (TDS of income from "professional services"- the latter expression defined expansively by Section 194J (3) Explanation (a)). Neither provision obliges the person making the payment to deduct anything from contractual payments such as those made for reimbursement of expenses, other than what is defined as "income". The law thus obliges only amounts which fulfil the character of "income" to be subject to TDS in such cases; for other payments towards expenses, the deduction to those entitled (to be made by the payee) the obligation to carry out TDS is upon the recipient or payee of the amounts.

Barjinder Singh Bhatti vs. ITO (ITAT Chandigarh)

S. 55A: If the AO is not satisfied with the valuation made by the assessee's valuer, he must refer the issue to the DVO. He cannot reject the assessee's valuation without any basis

The Assessing Officer, if was not satisfied with the report of the Registered Valuer, could have made a reference to the Departmental Valuation Officer under section 55A of the Act for the purpose of computing income from capital gains. The Assessing Officer has

thus, not acted in accordance with law and without any basis or evidence in his possession, did not accept report of the Registered Valuer. In the absence of any material on record, Assessing Officer should not have made his own calculation for the purpose of computing the capital gains.

Transfer Pricing

- Tecnimont ICB House vs. DCIT (ITAT Mumbai)

Important principles on benchmarking transactions of advances/ credit period to AEs reiterated

Since sale price of the product or service was always influenced by the credit period allowed by the seller, the transaction of sale to the AE and credit period allowed in realization of sale proceeds are closely linked and the price determined for such sale is after consideration of the credit period provided by the seller. Further, it was also held that for the purpose of determining the ALP of sale transaction, the transaction of excess credit period provided by the seller to the AE is required to be aggregated with the sale transaction by the seller to the AE and cannot be benchmarked separately

HCL Technologies BPO Services Ltd vs. ACIT (ITAT Delhi)

For the purpose of benchmarking the international transactions, the effect of underutilization of capacity/excess fixed costs has to be eliminated while computing the operating margins of the assessee

Under-utilization of production capacity in the initial years is a vital factor which has been ignored by the authorities below while determining the ALP cost. The TPO should have made allowance for the higher overhead expenditure during the initial period of production. The claim of the assessee with respect to idle capacity adjustment during the relevant period while determining the ALP cost. Economic adjustment on account of under capacity utilization when the assessee was in start up phase has to be considered.

CHARITABLE TRUST

Where an application seeking registration of a charitable trust is not disposed of by the Commissioner either by granting registration or refusing registration before the expiry of six months from the end of the month in which the application was received, it would not result in a deemed grant of registration ruled the Full Bench of the Allahabad High Court in CIT v. Muzafar Nagar Development Authority (2015) 372 ITR 209 (All) (FB).

INCOME FROM HOUSE PROPERTY

In A. Venkateswara Rao v. ACIT (2015) 372 ITR 136 (T & AP) where the assessee had let out his premises to the Telecom Department of the Government of India on a rent of Rs. 13,500 per month and the Assessing Officer determined the rent at a higher figure, the Telangana & Andhra Pradesh High Court observed that when the premises is leased to the Government or its organisations, the scope for an assessee to show the rent at a lower figure does not arise, that in such a case, the transaction is regulated by the fixed parameters, that even if the premises has potential to fetch a higher rent, the Government departments are not expected to pay such rent and that in such a situation, the Assessing Officer cannot ignore the actual payments and fix an imaginary figure based upon the alleged information or potential of the premises and held that the rent for the premises must be taken at Rs. 13,500 per month for computing the income from house property.

DEEMED DIVIDEND

The Bombay High Court has in CIT v. Jignesh P. Shah (2015) 372 ITR 392 (Bom) where the facts were that Lafin Financial Services Pvt. Ltd. advanced money to NS Fincon Pvt. Ltd. which in turn advanced money to the assessee and while the assessee held 50% of the shares in Lafin Financial Services Pvt. Ltd., he was not a shareholder in NS Fincon Pvt. Ltd., expressed the

view that since the assessee was not a shareholder of NS Fincon Pvt. Ltd. from which he received the loan, section 2(22)(e) had no application and the amount of loan received by the assessee could not be taxed as deemed dividend

M/S Indus Towers Limited Bangalore V/s State of Karnataka and Others 2015(81) VST 505 (Karn) The dealer has filed the original return with nil information and revised the return voluntarily and paid the taxes with applicable interest without any notice from the department. The Respondent contended that there is levy of penalty under section 72(2) of the Act. Section

Bombay Bar Association vs. UOI (Supreme Court)

In P. C. Joshi vs. UOI, a Writ Petition was filed in the Bombay High Court to challenge the levy of service-tax on advocates. It was claimed that an advocate renders services which cannot be said to be commercial or business like. They cannot be equated with the service providers mentioned in the Finance Act 1994.

It was also contended that advocacy is not a business but a profession and a noble one. An advocate is a part and parcel of the administration of justice and which is a sovereign or regal function and hence providing for a Service Tax on advocates would mean that their services will no longer be available or accessible to those seeking justice from a Court of law. That would defeat the constitutional guarantee of free, fair and impartial justice. The High Court dismissed the Petition and held that levy of service-tax on lawyers is valid. On appeal to the Supreme Court HELD by an interim order:

Until further orders, there shall be interim stay of the operation and implementation of the impugned final order and judgment passed by the High Court of Judicature at Bombay in W.P.(L) No.1764 of 2011, dated 15.12.2014

DUE DATES FOR STATUTORY PAYMENTS – AUGUST 2015



DATE	CATEGORY	COMPLIANCE REQUIRED	FORM NO. / CHALLAN NO.
6-Aug-15	Central Excise	Payment of Excise Duty for all Assesses	GAR – 7
6-Aug-15	Service Tax	Service Tax Payment for Month July (Companies)	GAR – 7
7-Aug-15	Income Tax	TDS/TCS payment for July	281
7-Aug-15	Income Tax	Form 15G/H submission received in July	
10-Aug-15	Central Excise	Monthly Returns for Production and Removal Of Goods and CENVAT Credit for July 2015	ER 1
10-Aug-15	Central Excise	Monthly Returns of Excisable Goods Manufactured & Receipt Of Inputs & Capital Goods By Units In EOU, STP, HTP for July 2015	ER 2
10-Aug-15	Central Excise	Monthly Returns Of Informations Relating To Principal Inputs For July 2015 By Manufacturer Of Specified Goods Who Paid Duty >=Rs. 1 Crore During Fy 2014-15 By Pla/Cenvat/Both	ER 6
15-Aug-15	Income Tax	Issue of TDS Certificate if deductor is office of Government for TDS made for quarter ending June 2015 Except on Salaries	16A
17-Aug-15	EPF	Payment of EPF Contribution For July 2015	
17-Aug-15	EPF	Consolidated Statements of dues and remittances under EPF and EDLI for July 2015	12A
17-Aug-15	EPF	Monthly returns of Employees who Joined/Left The Organisation In July 2015	
21-Aug-15	ESI	Deposit of ESI contributions and collections for July 2015	
31-Aug-15	Profession Tax	Payment and Return of July	
31-Aug-15	Income Tax	Annual Information Return	61A
31-Aug-15	Income Tax	Last date for return of Income/Wealth for the Py. 2014-15 For Non Corporate Assesseees whose accounts are Not Subject to audit Under the Income Tax Act (Due date extended To 31/08/2015 F.No.225/154/2015/Ita.li Dt. 10.06.2015)	ITR 1/2/3/4/5/7/8 WT:BA/BB

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Adukia & Associates

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OUR COMMITMENT

We are committed to provide consistent, customized and workable solutions to our clients and strive to support our services with the highest level of professionalism, efficiency and technology

OUR MISSION

To provide full range of high quality services in Auditing, Accounting, Taxation, Management consultancy.

To carry out all aspects of our work with high level of professionalism and excellence To offer value for money for the services we provide.

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