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AN ANALYSIS OF ACCOUNTING TREATMENT OF DEFERRED TAXES IN INDIAN CORPORATE SECTOR
(WITH SPECIAL REFERENCE TO MATERIALITY CONCEPT OF ACCOUNTING)

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Abstract

IAS-12(1996), AS-22 (2001) and Ind AS-12 (2016) require recognition, measurement and disclosure of deferred tax. Deferred taxes are recorded in the books either in form of deferred tax assets (DTA) or deferred tax liabilities (DTL). Disclosure of DTA and DTL is significant or not, it is checked with special references to materiality concept of accounting. According to materiality concept of accounting, only those transaction and event is recognized separately in the books of accounts which are material and significant. Financial information which is not material and insignificant no need to separately recognized what is significant (material) depends upon several factors like amount involved, size of business, nature and level of information required, relevance to decision. Whether amount of DTA and DTL should disclose separately with special reference to materiality concept of accounting or not? Here an attempt has been made to evaluate the relevance of DTA and DTL with special reference to materiality concept of accounting. In order to evaluate the DTA and DTL, only one dimension of materiality concept i.e. size of amount is considered. The size of DTA and DTL is determined is terms of % of those to total assets and sales. After analyzing ninety four sample units of different sectors of Indian corporate sector it has been found that the most of sample units having small percentage of DTA/DTL to sales and DTA/DTL to total assets, it means both have no significant impact on profit of company.

Keywords: *Deferred Tax Assets, Deferred Tax Liabilities, Materiality Concept of Accounting Theory.*

Introduction

IAS-12(1996), AS-22 (2001) and Ind AS-12 (2016) require recognition, measurement and disclosure of deferred tax. According to AS-22 and IAS-12 taxes on income are considered to be an expense incurred by the enterprises in earning income and are accrued in same period as the revenue and expenses to which they relate. Such matching may result in to timing difference. The tax effects of timing difference are included in the tax expenses in the statement of profit and loss as a deferred tax, deferred tax assets and deferred tax liability in balance sheet. In earlier years, deferred tax was recognized based on concept of timing differences,

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based on difference in accounting profit and taxable profit known as income tax liability method. The concept of stands revised with newly issue Ind AS-12 which recognized deferred tax based on temporary differences that arise due to difference in the carrying value of an item of assets or liability as per books of accounts with the carrying value of that item as per income tax provision known as tax base this method is known as balance sheet approach. Deferred taxes are recorded in the books either in form of deferred tax assets (DTA) or deferred tax liabilities (DTL). Disclosure of DTA and DTL is significant or not, it is checked with special references to materiality concept of accounting. According to materiality concept of accounting, only those transaction and event is recognized separately in the books of accounts which are material and significant. Financial information which is not material and insignificant no need to separately recognized what is significant (material) depends upon several factors like amount involved, size of business, nature and level of information required, relevance to decision. Whether amount of DTA and DTL should disclose separately with special reference to materiality concept of accounting or not? Here an attempt has been made to evaluate the relevance of DTA and DTL with special reference to materiality concept of accounting. In order to evaluate the DTA and DTL, only one dimension of materiality concept i.e. size of amount is considered. The size of DTA and DTL is determined is terms of % of those to total assets and sales.

Review of Literature

After extensively reviewing existing literature relating to DTA and DTL some scholarly work has been found. The details of these literatures have been summarized in the following paragraphs:

Ratu and Kusumaningrat (2017) analyzed the impact of deferred tax expense, leverage and size of the company on earning management of company. To fulfill the object of this research the data were collected from "The Jakarta Islamic Index (JII) listed on the Indonesia Stock Exchange for the period of 2012-2015 of 17 companies by using purposive sampling method. Multiple linear regressions were used for the analysis. The results of this study indicate that the deferred tax has significant effect on earnings management, while the leverage variable has no significant effect on earnings management.

Alexander Edwards (2017) concluded that the valuation allowance for deferred tax assets helps predict the future creditworthiness of a firm. Under the provisions of SFAS No. 109, a firm recorded a deferred tax asset which lead the expected future taxable income realize in the form of tax saving in the future. If a firm does not expect to generate sufficient taxable income to realize the asset, a valuation allowance is created to reduce the balance. As a result, the valuation allowance indicates management's expectation of future taxable income, which could be informative in predicting the ability of the firm to make future interest and principal payments on debt. Alternatively, the valuation allowance may not be informative regarding creditworthiness if it is a result of overly conservative accounting practices or if it is used as an earnings management tool.

Utari and Widiastuti (2016) examined the usefulness of deferred tax expense as compared to various accrual measures employed in prior research in detecting earnings management in two settings where earnings management likely occurs: to avoid loss and to avoid earnings decline. Manufacturing companies is listed at Indonesia Stock Exchange have taken as sample for the period 2010-2012 by purposive method. Results provide evidence that deferred tax expense, total accruals, and discretionary accrual of the Jones Model have no significant influence to detecting earnings management to avoid loss. Deferred tax expense has no incrementally useful beyond accruals measures with regard to detecting earnings management to avoid loss. The results of the second setting empirically showed that deferred tax expense has no significant influence to detecting earnings management to avoid earnings decline.

Trisnawati *et.al* (2015) analysed the information asymmetry, profitability and deferred tax on integrated earning. It proxies with real and accruals Earnings management, real earnings management is measured by abnormal cash flow of operation, abnormal production cost, and abnormal discretionary expenses. On the contrary, Accruals earnings management is measured by short and long term discretionary accruals. Descriptive qualitative used to measure the mean value of these proxies, then the integrated earning management measured by ranking of them. The results showed that information asymmetry has effect on earning management in JII and LQ 45 index. It has negative significantly on earning management in both indexes.

Johnston and Kutcher (2016) explored whether an accounting treatment required under IFRS to improve the ability of the stock-based compensation component of deferred tax assets to predict future tax payments, relative to U.S. GAAP. Data were gathered from S&P 500 firms. Researchers estimated the deferred tax assets related to employee stock options (ESOs) and restricted stock units (RSUs) and also found that the RSU deferred tax asset is negatively related to future cash tax payments, However after reducing the ESO and RSU deferred tax assets by their corresponding estimated impairments, authors find that both variables are negatively associated with future tax payments. Additional analysis also provide evidence for supports the conjecture that using a revaluation approach to account for stock-based compensation deferred tax assets may be more useful in predicting future tax cash flows.

Scott David White (2014) examined the impact of deferred tax assets on firm creditworthiness. The study investigated whether the proportion of total assets comprised of deferred tax assets associated with a firm's credit risk or not. It is found that increment in deferred tax assets is associated with higher levels of credit risk. Creditors are particularly concerned with the downside risk of a firm. If declines in financial performance lead to a subsequent default, the benefits of deferred tax assets, which are primarily realized through deductions from future taxable income, may provide no value to creditors seeking recovery of their investment. Also an attempt made by the researchers to provide insight into the impact of book-tax differences on the quality of a firm's balance sheet. Results were found that deferred tax assets may adversely impact the quality of a firm's balance sheet when evaluated from the perspective of a creditor. In order to test the relation between deferred tax assets and

credit risk used an ordered logit model to determine whether firms, with higher levels of deferred tax assets are associated with lower credit ratings.

Rick C. Laux (2013) provided evidence that deferred taxes provide incremental information about future tax payments, the magnitude of the information is small. The analysis demonstrated that there is an asymmetrical association between deferred taxes and future tax payments. For instance; deferred taxes associated with temporary differences that are included in GAAP income prior to taxable income are associated with future tax payments. In contrast, deferred taxes associated with temporary differences that are included in GAAP income after taxable income are not associated with future tax payments. Finally, the analysis provides evidence that growth in the deferred tax balances does not defer future tax payments

Todd A. Doehring (2012) described in his study that understanding the impact of deferred taxes of any business is vital for management decision- making and monitoring. Standardization facilitates the ability to compute useful and meaningful measures that are comparable to similar businesses. Author explores the issues and computation of deferred taxes on a balance sheet for a farm or branch as recommended by the Farm Financial Standards Council.

Poterba James*, et.al* (2007) investigated the importance of deferred tax assets and liabilities and documents substantial heterogeneity in the deferred tax positions of different firms. Its differ substantially in the composition of their deferred tax assets and liabilities. The largest components of deferred tax assets for sample firms are Loss and Credit Carry forwards and Employment and Post-employment Benefits. The largest components of deferred tax liabilities are Property, Plant & Equipment and Leases. They present new information on the aggregate value of both DTAs and DTLs, as well as on the effect of statutory corporate tax rate changes on these balance sheet items and on net earnings. They also discuss several non-tax policies that could affect deferred tax positions.

Guenther and Sansingr compares two attributes of a deferred tax liability (DTL) that arise from differences in book and tax depreciation methods. The first attribute is the effect of the DTL on the market value of the firm. The second is the length of time between when the asset is placed into service and when the DTL associated with that asset begins to reverse. Author explained that a decrease in the time it takes for the DTL to begin to reverse is neither necessary nor sufficient for the value of the DTL to increase. It also shows that the value of the DTL is *not* equal to the present value of the future deferred tax expense. The effect of one dollar of DTL on firm value depends only on the tax depreciation rate and the discount rate.

Phillips John (2003) assessed the usefulness of deferred tax expense in detecting earnings management assuming greater discretion under GAAP than under tax rules, and assuming managers exploit such discretion to manage income upward primarily in ways that do not affect current taxable income, then such earnings management will generate book tax differences that increase deferred tax expense. Our results provide evidence consistent with deferred tax expense generally being incrementally useful beyond total accruals and abnormal accruals derived from two Jones type models in detecting earnings management to

avoid an earnings decline and to avoid a loss. Only total accruals are incrementally useful in detecting earnings management to meet analysts' earnings forecasts. Deferred tax expense is more accurate than the accrual measures in classifying firm years as successfully avoiding a loss, whereas no one measure is more accurate in classifying firm years as avoiding an earnings decline or meeting analysts' forecasts

Objectives

In order to evaluate the accounting treatment of deferred tax with special reference to materiality concept the following objectives have been taken into account;

- To examine significance of deferred tax assets in terms of % of Sales
- To examine significance of deferred tax asset in terms of % of Total Assets
- To examine significance of deferred tax liability in terms of % of Sales
- To examine significance of deferred tax liability in terms of % of Total Assets

Null Hypotheses

H_{01}: There is no significant difference as percentage to DTA to Sales and DTA to Total Assets among sample units

H_{02}: There is no significant difference as percentage to DTL to Sales and DTL to Total Assets among sample units

H_{03}: There is no significant difference as percentage to DTA/DTL to Sales and DTA/DTL to Total Assets among the various sectors of Indian corporate

Statistical Tools

In order to test of significance of null hypothesis certain statistical tests have been administered like; t test, ANOVA tests. Descriptive statistics (mean, standard deviation and co-variance) is also taken in to account to examine the characteristics of data

Period of Study

The period of study for the purpose of present research work has been taken from 2010-11 to 2016-17, A study period of 7 years seems to be appropriate to establish the trend of DTA and DTL

Source of Data

The present study is based on secondary data. The relevant secondary data regarding to deferred tax reported in annual reports have been collected through online portal "ACE Knowledge portal" available at the website (www.mlsu.ac.in) of Mohanlal Sukhadia University Udaipur (Rajasthan) during December 2017 to February 2018.

Sample Design

The present research has been conducted on 94 sample units. These sample units have been selected from top 10 various manufacturing industry including Refineries, Fertilizers, Mining & Minerals, Automobiles - Passenger Cars, Trading, Pharmaceuticals & Drugs, Engineering – Construction, Power Generation/Distribution, IT – Software and Steel & Iron Products on the basis of turnover of 2017. Sample units have been selected on net sales basis around the various industries of 2017. While selecting the samples Bank, Shipping, Financing

companies and other services sectors has been excluded. Also those sample units has been excluded who suffered from losses because of DTA and DTL is resultant of profit element. Only 4 sample units has been considered in Automobiles - Passenger Cars industry because of maximum companies suffered from losses and some companies have not sufficient data.

Analysis and Discussion

In order to examine significance of DT in terms of materiality concept of accounting, DTA to sales and DTA to total assets , DTL to sales and DTL to total assets have been calculated for sample units of different sector of Indian corporate sector for 7 years. Here an attempt has been made to examine the materiality concept in relation to DT the Indian corporate sector have been divided in different sector. The detailed calculation have summarized in following paragraph.

Table 1: Percentage of DTA/DTL to Sales and Total Assets

S. No.	Sector	DTA/Sales	DTA/TA	DTL/sales	DTL/TA
1	Refineries	0.3910	0.7093	2.2281	3.1063
2	Fertilizers	1.2454	0.8360	3.2901	2.5318
3	Mining & Minerals	5.2286	3.0880	3.2513	1.2737
4	Automobiles - Passenger Cars	0.4879	0.6200	1.7652	2.3710
5	Trading	0.0960	0.1910	0.7493	0.8250
6	Pharmaceuticals & Drugs	3.2600	1.6100	5.1000	3.1700
7	Engineering – Construction	0.5600	0.4300	2.6200	1.7300
8	Power Generation/Distribution	8.8300	1.9100	14.3400	3.4100
9	IT – Software	2.1300	2.0000	0.4200	0.4200
10	Steel & Iron Products	1.2200	0.7100	4.5700	3.2500
	MEAN (Including outliers)	2.3449	1.2104	3.8334	2.2088
	MEAN (Excluding outliers)	1.6243	1.0017	2.6660	2.0753
	STD	2.7737	0.9090	3.9813	1.0855
	CV	118.2863	75.0976	103.8594	49.1458
t test value					
	DF	18		18	
	t statistics	1.2290		1.2449	
	t critical two tail value	2.1009		2.1009	

Source: *own calculation through MS-Excel-2007*

The above table No. 1 consisting 7 years average ratio (2010-11 to 2016-17) of DTA/DTL to sales and DTA/DTL to total assets for sample units in different industry

After intensive observation of this table, it is found that the average value of DTA to sales comes to (2.34%) and without outliers it comes (1.62%) **Power Generation/Distribution** industry reported highest ratio (**8.83**%**)**, another two more sector was also reported these ratio greater than the average ratio i.e. **Mining & Minerals industry, Pharmaceuticals & Drugs industry (**5.23%) and **(**3.26%) respectively. Average value of DTA to total assets comes to (1.21%). Whereas **Mining & Minerals industry** was reported highest ratio (**3.0880**%**)**, another three sectors were also reported more than average ratio i.e. **IT – Software industry, Power Generation/Distribution industry, Pharmaceuticals & Drugs industry (**2%), (1.91%) and **(**1.61%) respectively. Both ratio % DTA to sales and DTA to total assets are less than 2 % of Indian corporate sector, which may considered insignificant. The average value of DTL to sales comes to (3.8334%) with outliers and without outliers it comes to (2.66%) **Power**

Generation/Distribution industry reported highest ratio (**14.34%)**, another two sectors also reported more than average ratio **Pharmaceuticals & Drugs industry, Steel & Iron Products (**5.10%) and **(**4.57%) respectively.

The average value of DTL to Total Assets is comes to (2.21%) whereas **Power Generation/Distribution** industry was reported highest ratio (**3.41%)**. Another five sector were also reported more than average ratio **Steel & Iron Products industry, Pharmaceuticals & Drugs industry, Refineries, Fertilizers and Automobiles - Passenger Cars (**3.25%), **(**3.17%), **(** 3.10%), **(** 2.53%), and **(**2.37%) respectively. It is clearly indicates that % of DTA to sales and DTA to total assets ratio is less than 2 % and materiality concept of accounting may be applied here it may be concluded that there is no need to disclose DTA separately in the financial statement creation of DTA do not care a great impact on valuation of performance of company In order to check whether significant impact of DTA/DTL to Sales and DTA/DTL to Total assets of various industries t test have been administered in following hypotheses

Testing of Hypotheses No. 1

The first hypotheses entitled "There is no significant difference as percentage to DTA to Sales and DTA to Total Assets among sample units" is formed under the present research work. In order to examine the hypotheses, parametric test i.e. t test has been administered. The relevant data have been summarize in above table no. 1.The calculated value of t test is (1.2291). The calculation has been made through MS-Excel-2007. Our null hypothesis is accepted at 5% level of significance because the calculated value of t test (1.2291) is less than table value (2.2010). It may be concluded here that visible difference between average value of DTA/ sales (1.62%) and DTA/Total assets (1.00%) is due to sampling fluctuation and not due to major reason.

Testing of Hypotheses No. 2

The first hypotheses entitled "There is no significant difference as percentage to DTL to Sales and DTL to Total Assets among sample units" is formed under the present research work. The calculated value of t test is (0.9928). Our null hypothesis is accepted at 5% level of significance because the calculated value of t test (0.9928) is less than table value (2.2010). It may be concluded here that visible difference is due to sampling fluctuation and not due to major reasons.

Selection of DTA/sales or DTA/ total assets and DTL /sales or DTL/total assets

The analysis of 10 sectors of Indian corporate sector reveals that the % of DTA/DTL should be calculated on the basis of total assets or sales:

- There is no significant difference between % of DTA/ DTL to sales and % DTA/DTL to total assets as it is evident by "t" test
- But on the basis of Coefficient of variations, total assets should be used in calculation of ratio because the CV of DTA/ DTL to total assets comes to (75.09%), (49.15 %) respectively, which is lower than from DTA/DTL to sales (118.29%), (103.86%) respectively.

Testing of Hypotheses No. 3

The third hypotheses entitled "There is no significant difference as percentage to DTA/DTL to Sales and DTA/DTL to Total Assets among the various sectors" is formed under the present research work. In order to examine the hypotheses, parametric test i.e. ANOVA test one-way variance have been administered Because of number of average mean is more than 2 and also check whether any significant difference exits between different averages and various sectors. The relevant data have been summarize in following table no.2:

Table 2: One Way Variance of DTA/DTL to Sales and Total Assets of Indian Corporate Sector

Source of Variation	SS	DF	MS	F	P-value	F critical
Between Groups	16.47	3	5.49	1.5137	0.2274	2.8662
Within Groups	130.58	36	3.62			
Total	147.05	39				

Source: Own calculation through MS-Excel-2007

The F value is (1.5137). Our null hypotheses i.e. there are no significant difference as percentage to DTA and DTL to Sales and DTA and DTL to Total Assets among various sectors is accepted at 5% level of significance because the calculated value of t test (1.5137) is less than table value (2.960351) or p- value is more than .05, therein major variations exits within the group because sum of square comes at (130.58) which is show that major significant heterogeneity exits within the different sectors, i.e. above table no.2 the Power Generation/Distribution has reported (8.83%) highest % ratio of DTA to sales ratio whereas refineries sector has reported only (0.39%), another highest variable DTA to Total assets ratio reported by minerals and mines (3.08%) whereas only (0.19%) reported by trading, the Power Generation/Distribution has reported (14.34%) highest % ratio of DTL to sales ratio whereas IT- software sector has reported only (0.42%), another highest variable DTL to Total assets ratio reported by pharmaceutical (3.17%) whereas only (0.42%) reported by IT-software. But overall conclusion is no significant impact exits. It may be concluded here that visible difference is due to sampling fluctuation and not due to major reason.

Frequency distribution of DTA and DTL to sales and DTA and DTL to total assets ratio

In order to check majority of separate disclosure of DTA/DTL frequency distribution table has to be prepared.

Table 3: Frequency Distribution of DTA to Sales and DTA to Total Assets of Indian Corporate Sectors

		DTA/Sales						
	(%)	**0-2**	**2-4**	**4-6**	**6-8**	**8-10**	**More than 10**	**Total**
DTA/Total Assets	0-2	74	-	-	-	-	-	74
	2-4	2	9	1	2	-	2	16
	4-6	1	-	1	1	-	-	3
	6-8	-	-	-	-	-	-	-
	8-10	-	-	-	-	-	-	-
	More than 10	-	-	-	-	-	1	1
	Total	77	9	2	3	0	3	94

Source: Own calculation through MS-Excel-2007

The above table no. 3 indicates frequency distribution of Indian corporate sector regarding DTA to sales and DTA to total assets. 77 companies out of 94 approximately (82%) sample units of Indian corporate sector reported less than 2 % of DTA to sales. 74 sample units are also reported less than 2% DTA to total assets ratio approximately (79%)

Only 3 sample units out of 94 companies reported DTA to sales and DTA to total assets ratio more than 10%, approximately (3%) which is not significant.

Almost all companies (86 out of 94) reported DTA to sales less than 4%.It is clear indicates that the majority of sample units having these ratio less than 2%. If we define the materiality concept the creation of DTA, DTL may be avoided. Less than 2% of turnover may not be significant figures so; it does not affect the investing decision of investors. In nutshell creation of DTA/DTL do not have any significant impact on different stakeholders of the corporate sector. In order to compliance the accounting year concept it should be created in particulars year in which tax was deferred but since, value is not significant so it may have no impact on profitability of other accounting year.

Table 4: Frequency Distribution between DTL to Sales and DTL to Total Assets of Indian Corporate Sector

		DTL/Sales						
		0-2	**2-4**	**4-6**	**6-8**	**8-10**	**More than 10**	**Total**
DTL/Total Assets	0-2	49	3	1	-	-	-	53
	2-4	5	9	-	-	-	4	18
	4-6	2	3	9	3	1	1	19
	6-8	1	-	-	-	-	2	3
	8-10	-	-	-	-	-	1	1
	More than 10	-	-	-	-	-	-	-
	Total	57	15	10	3	1	8	94

Source: Own calculation through MS-Excel-2007

The above table no. 4 indicates frequency distribution of Indian corporate sector regarding DTL to sales and DTL to total assets, 57 companies out of 94 approximately (61%) sample units of Indian corporate sector reported less than 2 % of DTA to sales. 53 sample units are also reported less than 2% DTL to total assets ratio. 8 sample units out of 94 companies reported DTL to sales and DTL to total assets ratio more than 10%, 72 sample units out of 94 companies reported DTA to sales less than 4%.

It is clear indicates that the majority of sample units having these ratio less than 2%. If we define the materiality concept the creation of DTA, DTL may be avoided. Less than 2% of turnover may not be significant figures so; it does not affect the investing decision of investors. In nutshell creation of DTA/DTL do not have any significant impact on different stakeholders of the corporate sector. In order to compliance the accounting year concept it should be created in particulars year in which tax was deferred but since, value is not significant so it may have no impact on profitability of other accounting year.

Concluding Remarks

After analyzing ninety four sample units of different sectors of Indian corporate sector with special reference to materiality concept of accounting, it has found that the most of sample units having small percentage of DTA/DTL to sales and DTA/DTL to total assets, it

means both have no significant impact on profit of company, and also found that very small percentage of sample units present significant impact of DTA/ DTL to sales and DTA/ DTL to total assets through frequency distribution table. At the end the study has conclude that no need of separate disclosure of DTA and DTL in financial statement of sample units. Further analyses would have been considering in study with special content of materiality concept of accounting; following remarks have been obtained from above analysis;

- Since DTA and DTL to Total assets have less CV it may be taken as base for checking materiality concept
- Only those sectors have needs to separate disclosure of DTA and DTL which has significant impact. In above research found three sectors i.e. power generation, minerals and mines and pharmaceutical.
- Since null hypothesis (H_{03}) is accepted. It means DTA may be calculated as % either sales or total assets. No impact occurred on further analysis
- The analysis reveals that the average % of DTL to sales/total assets is higher than DTA to sales/ total assets, which shows the clear intention of different sectors to postpone its tax liability in future.
- Only 11 sample units out of 94 companies charged more than 10% of DTA/ DTL to sales and total assets which lead (11.70%), and most of sample units i.e. 77 companies out of 94 approximately (82%) sample units of Indian corporate sector reported less than 2 % of DTA to sales. 74 sample units are also reported less than 2% DTA to total assets ratio approximately (79%)57 companies out of 94 approximately (61%) sample units of Indian corporate sector reported less than 2 % of DTA to sales. 53 sample units are also reported less than 2% DTL to total assets ratio. It's clearly indicate that no need to separate disclose DTA and DTL according to materiality concept of accounting.

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- ***Deferred tax liabilities (DTL)*** are the amount of income taxes payable in future periods in respect of taxable temporary differences.
- ***Deferred tax assets (DTA)*** are the amounts of income taxes recoverable in future periods in respect of: deductible temporary differences, the carry forward of unused tax losses and the carry forward of unused tax credits.
- ***Materiality concept of accounting according to American association,*** "an item should be regarded as a material if there is reason to believe that knowledge of it would influence the decision of the investor" The decision about materiality depends upon the needs of the users of information, common sense and judgment, size of business, nature of transaction and amount involved.

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