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The Management Accountant

The Journal for CMAs

The Institute of Cost Accountants of India ● www.icwai.org

Arm's Length Pricing : Role of CMAs

THE MANAGEMENT ACCOUNTANT | Vol. 47 | NO. 5 | Price : Rs. 60.00

President of the Institute and dignitaries lighting the lamp at the inaugural function of Vapi-Daman-Silvassa Chapter. Also seen Vice President and Chairman, WIRC.

President of the Institute releasing souvenir and house magazine of Vapi-Daman-Silvassa Chapter. Also seen Vice President, Smt. Aruna Soman, Council Member & other dignitaries.

A happy moment shared by President, Vice President of the Institute, Council Members Shri A.S. Durga Prasad & Smt. Aruna Soman & a member of Navi Mumbai Chapter.

Secretary, NIRC addressing the audience on Budget. Also seen, Chairman, Noida Chapter (extreme left) & other dignitaries.

Vice President of the Institute giving award to a student of Vapi-Daman-Silvassa Chapter.

President of the Institute inaugurating the office of Vapi-Daman-Silvassa Chapter.

Vice Chairman, SIRC addressing students at the Orientation Programme. Also seen Chairman Coaching Committee and Vice Chairman, SIRC.

Shri Basudeb Banerjee, Secretary, Ministry of Commerce, Industries & IT, Govt of WB lighting the lamp at Regional Cost Conference in Durgapur. Also seen Shri Sugata Marjit, Chairman, West Bengal Council of Higher Education, Shri P. K. Bajaj, CEO, Durgapur Steel Plant, SAIL, President, Vice President of the Institute & other dignitaries.

Inside *This Issue*

The Management Accountant

Official Organ of the Institute of Cost Accountants of India established in year 1944 (Founder member of IFAC, SAFA and CAPA)

Volume 47 ▣ No. 5 ▣ May 2012

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IDEALS THE INSTITUTE STANDS FOR

❏ to develop the Cost and Management Accountancy profession ❏ to develop the body of members and properly equip them for functions ❏ to ensure sound professional ethics ❏ to keep abreast of new developments.

MISSION STATEMENT

"The Institute of Cost Accountants of India Professionals would ethically drive enterprises globally by creating value to stakeholders in the socio-economic context through competencies drawn from the integration of strategy, management and accounting."

VISION STATEMENT

"The Institute of Cost Accountants of India would be the preferred source of resources and professionals for the financial leadership of enterprises globally."

DISCLAIMER

The views expressed by the authors are personal and do not necessarily represent the views and should not be attributed to the Institute.

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The term 'arm's length' has been defined in the Kohler's Dictionary for the Accountants as something done ''on a commercial basis, dealing with or as though dealing with independent, unrelated persons; competitive; straightforward; involving no favouritism or irregularity; as, arm's length purchase''. It is also suggested in the said dictionary that transactions between affiliated companies are not ordinarily regarded as being at arm's length even though expressed in terms of market values. The point in particular is that, if two or three divisions or units / plants of a company enter into commercial transactions, say, intercompany transfer of goods and services, there will be no impact on the profit / loss of the entity even if one division charges another a price which is more or less than their commercial value. So for the entity, it remains a zero sum game. However, if the transaction is between two independent parties and the transaction is entered into for a price less than its commercial value, it impacts the ultimate profit or loss of the entities. It is this relative gain or loss of the business entities which makes arm's length pricing a very important aspect of the transfer pricing mechanism.

It is very common to find multi-divisional / multi-locational conglomerates which, by their inherent nature, have production and distribution facilities spread across different states and even countries with varied tax jurisdictions and implications. Decision to host a particular facility in a particular location or country is influenced by the strategic considerations. However, when the goods and services are exchanged between two or more divisions of the same enterprise, but located in different tax jurisdictions, the tax authorities will view the supplier of the goods and services as seller and the receiver as buyer, even though the transaction is essentially between two divisions or units of the same enterprise. This principle, known as the arm's length principle, is now part of the international consensus and also the cornerstone of the OECD principles of transfer pricing guidelines for the multinational enterprises around the world. Arm's length pricing would not only help the revenue authorities to get their reasonable share of tax revenues from the activities of the multinational entities in their territories, but would also lead to fair international allocation of income.

Although the logic of arm's length pricing appears to be straightforward, but in reality it requires robust economic analysis and a clear understanding of not only the functioning of the market, but also of the subtle factors like the economic divers and the mechanisms in the market. Behind the theory of arm's length pricing there is clearly an assumption that there is a free flow of information in the market and the parties involved—the multinational entities and the revenue authorities of the respective tax jurisdiction—are able to gather it whenever needed. Such an assumption, however, is not only naive, but it faces challenge from the theory of efficient market hypothesis, which comes in a strong, semi-strong and weak form. Indeed, the world we live in is better explained, not by such phenomena as perfect market or perfect information, but by the existence of imperfect market where information asymmetry prevails. Parties involved in such a situation can come up with differing interpretations for the same event and get muddled up in disputes. International transfer pricing is one such area, which upholds arm's length principle, but ends up in a maze of disputes while practically applying it. Perhaps, this explains why India is locked in tax disputes with several multinational entities involving thousands of crores in tax revenues.

International transfer pricing is one such area, which upholds arm's length principle, but ends up in a maze of disputes while practically applying it.

Considering the importance of the topic, the timing for deliberations on arm's length pricing in the pages of the Management Accountant could not be more perfect! I hope that our eminent contributors to this issue of the magazine will enlighten us on the various aspects of the problem and offer food for thoughts for our readers.

M. Gopalakrishnan, President

We can see better with open eyes,
we can hear better with open ears and
we can perform better with open minds

—Anonymous

Dear Professional Colleagues,

The value addition provided by a profession supplements and strengthens the statutory role which it normally plays under the legal framework by the government. As long as this aspect is recognized by the profession, the respect for it increases. Sometimes we get a rare opportunity to present this aspect to the Government during the formulation of the statute, so that the same can be incorporated in an appropriate form in the regulations. Our Institute utilized this opportunity when the new CARR and CAR notifications incorporated the Part III - Performance Reporting to the management, as a part of the report to be submitted by the Cost Auditor. This key aspect was discussed in the recent interview I gave to the Economic Times, which not only highlighted the value added role played by the CMAs but also touched on the most vital aspect of the ''need for intelligent decisions based on thorough knowledge of the ... internal working''. The new notifications have respected the management's role in developing internal decision systems based on a robust cost and management platform and have mandated the cost auditors to concentrate more on testing the internal cost reporting systems and introduce best practices that are enshrined in Cost Accounting Standards into those systems. This aspect has been recognized by the Cost Audit and Assurance Standard Board, when it has put ''acquiring knowledge of the business process'' as the first point in the Exposure Draft on CAAS 320.

The Government also looks at ethical, economical, efficient and effective operations and safeguarding resources against loss, as the building blocks of the implementation of the various schemes. The CAG's office has highlighted this as the key aspect in the policy document defining the role played by them in discharging their constitutional functions. While the role of external financial accounting professionals, who are engaged in transaction audits for Government schemes have been predominant so far, our Institute has been constantly representing for a role for the last three aspects i.e. efficient and effective operations and safeguarding resources against loss, which can be done only by CMAs. The Institute has also got the go ahead for conducting training programme for the Govt. officials on this aspect. But let us also admit that this requires tremendous effort in capacity building amongst our practicing professionals, whose number is growing day by day. The Regional Councils and Chapters have to play a major role on this aspect, and I have been also highlighting this aspect during my interactions with them. The technical guidance on this matter is always available from the Institute and the newly formed CEP-2, will also help in conducting the capacity building seminars for the practitioners.

I am glad to inform you that the Ministry of Corporate Affairs has formed a Committee to formulate a Policy Document on Corporate Governance under the chairmanship of Shri Adi Godrej, and our Institute has been made a member and I attended the first meeting of the Committee held on 5th April 2012. During the meeting Dr. M. Veerappa Moily, Honourable Union Minister of Corporate Affairs, articulated the Government's view on laying down a policy on Corporate Governance and the background for the creation of the Committee consisting of representatives from industry, professional bodies and other stakeholders to discuss and arrive at a well structured policy on Corporate Governance drawing from the experiences of the past and the current thinking on the subject.

Members may recall that the Institute has been made a member of the Government Accounting Standards Board, w.e.f. Jan 2012. The first meeting of the Board was held on 20th April, 2012 at New Delhi. The activities of the Directorate of Advanced Studies started off in full swing with the Board of Advanced Studies holding its first meeting on 7th April, 2012 followed by the next meeting on 20th April 2011. This has accelerated the starting of the Advanced Courses that have been planned by the Institute. The details have been given elsewhere in this message.

The Council meeting held on 31stMarch 2012, also took some key decisions on holding of conferences. It was decided that the various national conferences will be held in all the four regions so that each region gets an opportunity to hold at least one national event per year. The National Cost Convention, National Practitioner's Convention, National Student's Convention and the National Regional Council and Chapter's Convention will be held in each of the four regions. It was also decided that each Region will hold one Regional Conference per year in a city as decided by the Regional Council, instead of multitude of Regional Conferences being held in various cities in some Regions. The First Foundation Day of the Institute will be held at New Delhi on 19th May 2012, which falls on the day on which the Act was passed by the Parliament.

As a strong believer in embracing best practice and installing systems in all operations of the Institute, sincere effort is on to install new system driven operations and having standard operating practice in place. A comprehensive guideline is almost in its final shape.

As the Institute's operations are expanding, new recruits are taking place in various departments. I hope that with the combinations of the experience of the senior executives and the enthusiasm of the new blood Institute will thrive further in the right direction.

I am also happy to inform you that myself and Vice President, Shri Rakesh Singh were invited to attend the 1st meeting of the reconstituted Quality Review Board of the Institute, held on 10th April 2012 under the Chairmanship of Shri R.S Sharma, Ex-CMD, ONGC. We assured that the Institute shall provide full support for the efficient and effective functioning of the Board.

Regional Council and Chapter Events

The meeting organized on 11th April 2012, jointly by Confederation of Indian Industry and our Institute, was a good event showcasing the benefits of institute industry partnership. Myself and Vice President accompanied by the Central Council Members CMA. Dr.Sanjiban Bandyopdhayaya and CMA. Manas Kr. Thakur were able to have detailed interaction with members and chapter representatives who attended the conference.

One of the major initiatives of the Ministry of Corporate Affairs, the Indian Institute of Corporate Affairs, moved into their state-of-art new premises at Manesar, which was inaugurated by the Honourable Prime Minister Dr.Manmohan Singh ji. It was heartening to note the Prime Minister in his speech highlighting the role of professional bodies along with the corporate sector in the growth of the Indian economy.

I was happy to inaugurate the new extended conference hall by the Lucknow Chapter on 21st April 2012, along with the Vice President. We had very good interaction with the large number of members present on the occasion in which the developmental works that can taken up for the profession were discussed.

Student's matters

Studies

To facilitate the student community, the Studies Directorate already started a new logistics system whereby, the students on the registration day itself will be provided with the requisite study material. Although this process has taken off well, I find that many chapters are still following the old manual system, in spite of the continuous communication from the Directorate of Studies about implementation of the IEPS system for student registration. This is putting lot of students into problems as some of the chapters are accumulating the applications and completing the registrations in one go in the last minute. I request the Regional Councils and Chapters to co-operate with the Directorate of Studies so that the students at large are benefitted by the initiative.

Examination

The Examination Directorate is busy in making all arrangement for the ensuing June 2012 term of examination all over India and overseas centers. This time, for further strengthening the process of conduct of examination, photo attendance sheet along with photo admit card will be in place which will streamline the examination process further.

Technical Directorate

I am happy to note that the CASB in its 52nd meeting held on 16th April has cleared the Guidance Note on CAS-7 on Employee Cost. In addition, the CAASB in its 9th meeting held on 17th April has cleared the CAAS-320 on Planning an Audit of Cost Statements and CAAS-340 on Audit Documentation. Both the drafts are likely to be discussed by the Council in its forthcoming meeting.

The Technical Directorate Extension Centres have started their activities in right earnest and the meeting of CFOs from various industries was organised on 25th April, 2012 at Chennai. Myself, Vice President, Shri. B. R. Prabhakar Chairman, SIRC, Shri J. P. Singh, Director (Technical) and Ms. Chandra. V, Advisor (TDEC-Chennai) used the meet to trigger Special Interest Group focusing on sector specific issues, which was welcomed by the CFOs present.

Training and Placement Directorate

Placement

I am also pleased to inform you that the Campus Placement Programme for December 2011 qualified CMAs has been successfully completed in all the four Regions during the month of April. Corporate like TCS, HCL GENPACT visited our campus for the first time and showed lot of interest in hiring our CMAs. PSUs like Coal India, ONGC and other Corporate like Wipro, Saint Gobain, Pidilite, CIPLA, Amtek, Accenture, Mukund, Suzlon and Nestle India visited our campus to find their future managers. Some more Banks / Corporate have also expressed their willingness to recruit our qualified CMAs in the month of May 2012. The credit for making the entire placement program a success goes to the integrated approach adopted by Placement Directorate under the guidance of Chairman-Members in Industry Committee and the Regional Councils and I compliment them for their efforts.

Training

I have already shared the news of the tie up we have made with Food Corporation of India for engaging cost trainees. Many more Corporate have expressed their interest to absorb our Intermediate qualified students as Trainees. While nearly 500 companies have already been compiled for Training our students, many Corporate giants like MMTC, NBCC, NHPC and Chennai Metro Water have recruited Intermediate qualified students as Trainees in the recent months. Majority of the students undergoing Training are enrolled with Practicing Cost Accountants. With the scope for practice expanding, I am sure more and more students would enroll with Practicing Members. As the Industry is nowadays concerned about the employability factor of the students of this country, I am sure our students trained by Industry and Practicing Members would have a great future.

Professional Development Directorate

As all of you are aware, the Ministry of Corporate Affairs Cost Audit Branch vide General Circular No. 15/2011 dated 11th April, 2011 changed the procedure for appointment of cost auditors by the companies. The Central Government has issued revised version of Form 23C and Form 23D with effect from 21st April, 2012. Prior to revised version, the companies who would like to appoint same cost auditor for multi products / units were required to file individual Form 23C for each of products under cost audit but new version allows filing of single Form 23C if a company wants to appoint one and the same cost auditor for the multi products / units. Such filing would facilitate cost accountant appointed as cost auditor for all the products of same "company" to be counted as one "Company" for the purpose of limit under section 224(1B) of the Companies Act, 1956. Similarly, Form 23D relating to information by cost auditor to Central Government would facilitate the one and same cost auditor to furnish the information of his / her appointment as cost auditor for the multi products / units. The revised version of new Forms 23C and 23D along with instructions for filing up these forms are hosted on the Institute website and MCA21 website.

CEP-I Directorate

I am pleased to inform that well known international authority on Accounting Standards, Dr. T P Ghosh, Professor, IMT Dubai conducted the workshop by the Institute in order to help the Corporates to update their knowledge on the Revised Schedule VI to the Companies Act 1956. As expected, Dr.Ghosh was able to impart a practical approach to the concept, which has triggered the demand for more such workshops in future.

I request the members to go thru the calendar of Management Development Programmes for the year 2012-13 which has been brought out by the Directorate incorporating the new topics and other contemporary topics for up-dation of the CMA professionals. The same is being published in the Journal for the information and use of our members and others.

CEP-2 Directorate

I am happy that the CEP-2 Directorate is planning to bring soon the webinars of some of the technical sessions of the eminent faculty members for the benefit of our members and students. The Directorate had discussions with many Government Departments and other organizations for organizing exclusive tailor made in-house programmes for them during the year 2012-13.

Membership Directorate

I am glad to inform you that the scheme of Benevolent Fund is being redesigned for providing more benefit to the members of the Fund. For this purpose, the Life Membership fee for the Benevolent Fund has been raised to Rs. 2500/- (one-time payment) from the existing fee of Rs. 2000/-. For the purpose of obtaining benefit from the Fund, a member should ensure to pay his up to date Associate / Fellow membership fees to the Institute and his name should continue to exist in the Register of Members of the Institute. I request the members to take full advantage of the membership to the Benevolent Fund.

Journal Directorate

I am happy to share that 'The Management Accountant' journal has now come with a new professional 'avataar' —in full colour, thereby fulfilling the wishes of all our members. This has improved the external look and get up of the journal significantly and is now comparable with some of the best of the journals in the country. I complement the Chairman and the members of the Journal Committee for this. The use of 'map litho' paper of the best quality and superior printing has contributed to a great extent in the beautification process. I am also happy to know that the efforts to continually enhance the qualitative aspect of the journal by inviting practical articles from corporate managers, industry experts and practicing members is bearing fruition. As members can see that the April 2012 journal has 90% of the coverage from the practical point of view. I request all subject matter experts in various industries to continue to contribute to the knowledge base of one and all through the official organ of the Institute.

Advanced Studies Directorate

In the month of April, the Board of Advanced Studies met twice in order to finalize and launch two of its initial courses on :

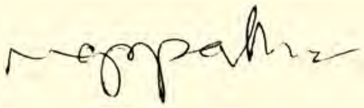
(I) Business Valuation and Corporate Restructuring, and

(II) Treasury and Financial Risk Management

The above two courses are expected to be launched soon and the details on the courses shall also soon be made available to interested candidates. It has been decided that more of such advanced studies courses in the field of cost and management accountancy and other allied disciplines, that enjoy market demand and scope can be launched for our members in the future. I am glad that best of the minds from academia and industry comprising the Advanced Studies Board are putting their efforts and experience in designing these courses for the benefit of our members and the profession, on the whole.

My best wishes to the members and their families for Budh Purnima and other festivals during the month,

Sincerely yours,



CMA M. Gopalakrishnan
President
The Institute of Cost Accountants of India
1st May 2012

Aruna Soman
Chairperson,
Committee on Banking & Insurance
Members' Facilities & Services Committee

Dear Professional Colleagues,

It gives me immense pleasure to address all of you through 'Management Accountant' as chairperson of the Committee of Banking & Insurance. I further feel privileged, to also work as Chairperson of the Committee for Members' Facilities & Services.

As we all know effective from 1st February, 2012 the name of the institute has changed to the Institute of Cost Accountants of India. The Associate and Fellow members of the Institute are now entitled to use the acronym 'ACMA' and 'FCMA' after their names. With this, the members have got due recognition and are entrusted with additional responsibility to preserve and enhance their work profile. The Practicing Members of the Institute can now enter into a Limited Liability Partnership (LLP), in accordance with the LLP Act, 2008. The detailed guidelines in this regard are uploaded on the Institute's website. I request the professional colleagues to visit the Institute's website regularly, which is constantly updated to serve you better.

The institute has written to the members to update their changed postal addresses, contact numbers and email addresses, on a regular basis, to enable the Institute to communicate with them better and faster. I am delighted to inform that in the last six months, we have brought down the response turnaround time of queries generated by the members to a great extent. We further hope to improvise the assistance in the near future, with the web-based software service, such as online application for membership, advancement to fellowship, payment of the dues, etc.

I am glad to inform you that in the last one year, we have added almost 550 practicing members, 1700 associate members and 320 fellow members and with the growth of the Institute on various fronts, both in terms of academic development and industrial interface, these figures would escalate in the days to come.

The role of the Committee on Banking & Insurance under the present scenario is very important and the Committee has initiated networking activities with Banks and Insurance companies, in order to open business avenues for the Practicing Members and facilitate employment avenues for the members and students completing their final examination.

Representations have been made to Reserve Bank of India, so that our members may partake in providing strategic guidance to ailing companies and to work hand in hand with Asset Reconstruction Companies, to improve the climate of recovering bank dues. Representation has also been made to provide guidance on Risk Based Internal Audit and Concurrent Audit of Commercial Banks. This will give our Members an opportunity to work with them, in view of the fact that the banks may implement improved internal control framework for IT audit procedure. Representation has also been made to SEBI to include Cost Accountants as investment advisers, in accordance with its regulation of Investment Advisers.

The Committee is also in the process of dialogue with the regulators such as SEBI, RBI and IRDA to discern avenues where the professional members can contribute, by offering their valuable services in the Stock market and Banking and Insurance sector of the country.

In this regard, the Committee has already taken the initiative of reviving the agreement with ISACA, for training our members and students, to build capability in carrying out Information Systems Audits in Financial Institutions.

I will fall short in my responsibility if I do not convey my gratitude to the President of the Institute and all my colleagues in the Council, for the confidence they have shown in me, by entrusting me with this task and for their cooperation and incessant support. I also express my deep felt appreciation towards my team members from the department, for their sustained assistance and back up.

Aruna Soman
Chairperson,
Committee on Banking & Insurance
Members' Facilities & Services Committee
1st May 2012

Arm's Length Price—CMA in India—a Perspective

Santonu Moitra

M.Com., ACMA, CS, MBA, CIA (IIA)
Dy. Manager (F & A), ONGC Ltd.

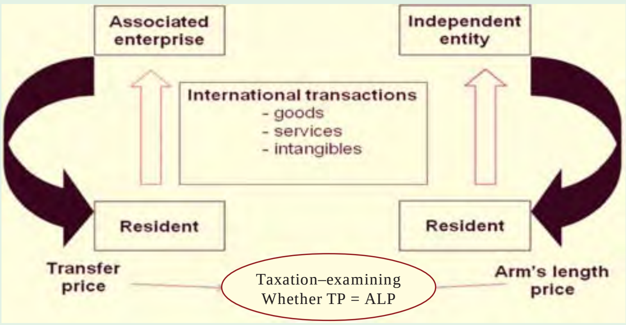
With globalisation of business and with companies operating in different geographic and geopolitical areas because of cost, tax marketing efficiencies the Taxation of the transaction among these different located companies has led to the development of Transfer Pricing Regulations and determination of Arms Length Prices. Globalisation is one reason for this interest, the rise of the multinational corporation is another and with the fact that more than 60% of world trade takes place within multinational enterprises, the importance of transfer pricing becomes clear.

The present framework for Arms Length Prices was triggered mainly by US regulations in 1990 on intangible tangible and cost sharing. Today's framework is mainly based on OECD guidelines issued in 2010. The international standard that OECD Member countries have agreed should be used for determining transfer prices for tax purposes is set forth in Article 9 of the OECD Model Tax Convention as : where ''conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.''

A company in X country buys gearboxes from its own subsidiary in country Y (Y only does business with X). The price at which the company in X parent pays its subsidiary—the transfer price—will determine how much profit the Y unit reports and how much local tax it pays. If the company in country X pays below normal local market prices, or lower than the Cost of production of the unit in country Y,the unit in country Y may appear to be in financial difficulty, even though the group as a whole shows a decent profit on the vehicle sold in country X. The Tax Authority in country X will not be effected as the additional profit will be reported at their end, and revenue will gain, but in country Y the Tax Authorities will be losing Tax revenue and will not have much profit to tax on their side of the operation or, even, there may be a loss if the transfer price is set at lower than cost of production. Further, if there is tax rate differential between X and Y then there can be a considerable gain to the company also at the cost of Tax revenue.

This example gives the perspective why the transfer pricing regulations are necessary to protect the revenue of the countries.

In Indian context the provisions have been enacted with a view to provide a statutory framework which can lead to computation of reasonable, fair and equitable profit and tax in India so that the profits chargeable to tax in India do not get diverted elsewhere by altering the prices charged and paid in intra-group transactions leading to erosion of our tax revenues—CIRCULAR NO.12 OF 2001, dated 23.08.2001of CDBT.



Circular No. 14/2001 dated 27/11/2001 : The increasing participation of multinational groups in economic activities in the country has given rise to new and complex issues emerging from transactions entered into between two or more enterprises belonging to the same multinational group.

The profits derived by such enterprises carrying on business in India can be controlled by the multinational group, by manipulating the prices charged and paid in such intragroup transactions, thereby leading to erosion of tax revenues. This gives the rationale for Transfer Pricing Regulations.

Indian transfer pricing regulations are exhaustive in many respects and are broadly based on the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ('OECD Guidelines').

Legislation introduced effective from April 1, 2001

Sec. 92 to 92F of Income Tax Act, Rule 10A to 10E Income Tax Rules, 1962, Circular No 12, Aug 23 2001, Circular No 14, Dec 24 2001, Administrative guidelines May 20 2003.

Provisions applicable only if there is an international transaction(s) [Section 92B] 'between' two or more associated enterprises [Sec. 92A].

As per Sec. 92B 'international transaction'' means a transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing money, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises and shall include a mutual agreement or arrangement between two or more associated enterprises for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises.

In the Finance Bill 2012 it is proposed to retrospectively amend the term 'international transaction' to specifically include :

- Guarantees
- Any debt arising during the course of business (e.g. credit period on outstanding receivables);
- Business reorganisations or restructuring, irrespective of whether the same has an impact on current year's profits, income, losses or assets.

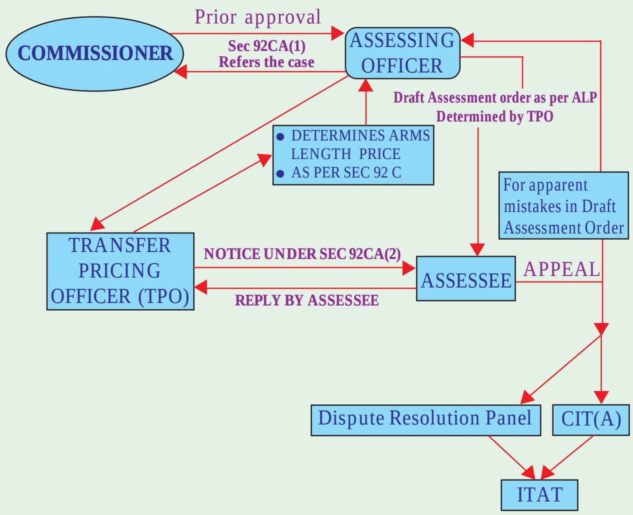
Intangible properties including marketing intangibles, human assets, technology related intangibles, etc.

This amendment will take effect retrospectively from 1 April 2002 and will apply in relation to FY 2001-02 onwards.

Deeming provisions [Section 92B(2)]

Transaction between an enterprise and a person (other than an associated enterprise) shall be deemed to be a transaction between two associated enterprises, if there exists a prior agreement or the terms of such a international transaction are in substance determined between one of these entities and the associated enterprise of the other contracting entity

Overview of Indian Regulatory Process for Transfer Pricing and Arms Length Transaction



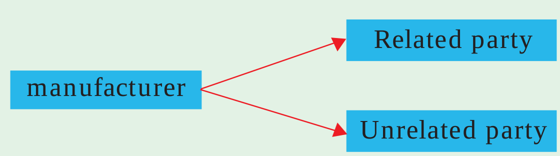
Transfer Pricing Methods

Comparable Uncontrolled Price (CUP)

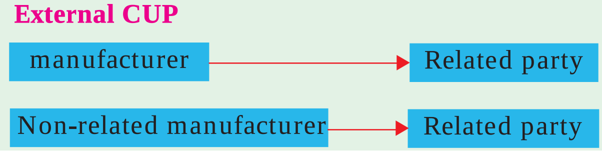
Where the price charged for goods, services or property transferred in a controlled transaction is compared to a CUT (comparable uncontrolled transaction). The CUT acts as the benchmark for determining the ALP. It is the most direct way in determining the Arms Length Price (ALP) The OECD reports prefer this method among all methods if it can be used and such comparable data is available. Adjustments to CUP is allowable by taxation authorities which include Credit Terms, volume of sales, logistics and other transaction costs etc to arrive at the ALP.

The various practical difficulties in applying this method are that there could be differences between controlled and uncontrolled transactions in the nature of volume of business, geographic market, timing of transactions, product life cycle, intangibles branded vs generic products etc. Also, accurate information like quality of products, various terms of transaction etc. is not available in the public domain.

Internal CUP



External CUP



VVF Limited vs. DCIT—(ITANo. 673 -MUM - 08): It was held by the ITAT that the transaction of lending money by the assessee by way of interest-free foreign currency loan to its foreign subsidiaries, should be compared with a company lending in foreign currency to unrelated party. It was observed that the ICICI Bank had advanced foreign currency loan to the assessee at LIBOR plus 3%. This can be taken as an "internal CUP" as the credit rating of subsidiary merges with the credit rating of the Parent. The comparison of interest should not be benchmarked with the Cash Credit @ 14% given to the Assessee.

Resale Price Method

The resale price method begins with the price at which a product that has been purchased from an associated enterprise is resold to an independent enterprise. This price (the resale price) is then reduced by an appropriate gross margin on this price (the ''resale price margin'') representing the amount out of which the reseller would seek to cover its selling and other operating expenses and, in the light of the functions performed (taking into account assets used and risks assumed), make an appropriate profit. What is left after subtracting the gross margin can be regarded, after adjustment for other costs associated with the purchase of the product (e.g. customs duties), as an arm's length price for the original transfer of property between the associated enterprises. This method is most useful where it is applied to marketing operations. An appropriate resale price margin is easy to determine where the reseller does not add substantially to the value of the product. In contrast, it may be more difficult to use the resale price method to arrive at an arm's length price where, before resale, the goods are further processed or incorporated into a more complicated product so that their identity is lost or transformed (e.g. where components are joined together in finished or semi-finished goods).

Another example where the resale price margin requires particular care is where the reseller contributes substantially to the creation or maintenance of intangible property associated with the product (e.g. trademarks or trade names) which are owned by an associated enterprise. In such cases, the contribution of the goods originally transferred to the value of the final product cannot be easily evaluated.

X is the subsidiary of C, which is a multinational parent company.

C has two similar models of machinery model A & model B.

Both models are similar in terms of properties, construction, production processes and functions and are comparable

C sells model A to X(a controlled transaction), which, in turn, sells them to independent retailers. Sales-force Training and warranty risk are borne by X

On the other hand, C sells model B to D independent company which sells to independent retailers. C trains D's sales-force and develops training material for them free of cost, and bears all the cost and bears warranty risk.

Both Xand D is tax resident of the same country

Markets of models of machinery A & B are same

X purchased 1,000 model A from C @1,000/ machine.

X sold the 1,000 model A to a number of independent retailers @ 1,100/.

X spent Rs. 14,000 on developing its own training material and trained its own sales force on and the warranty costs are Rs. 30,000.

For calculation of ALP on transaction between X and C :

X selected the transaction between C and D as a comparable uncontrolled transaction.

The gross profit margin earned by D from the resale of model B to independent retailers was found to be 10%.

Sales to third parties of × (1,000 model A@ 1,100)	=	1,100,000
Purchases from C 1,000 Model A @ 800)	=	800,000
Gross Profit	=	300,000

Functional analysis reflects a number of differences (Training Sales-force and warranty) between the controlled and the selected comparable uncontrolled transactions, which materially affect the gross margin —hence adjustments to the ALP is required.

Arms length Gross Margin on the basis of sales of Model B machines by C to of D @10% 110000

Add :

Adjustments for functional and risk differences:

Training costs	14,000
Warranty costs	30,000
Total adjustments	44,000
Adjusted gross profit	154,000

Adjusted transfer price of model A from C to X

= X net sales of model A – Adjusted gross profit

= 1,100,000 – 154,000 = 964,000

Adjusted Arms Length transfer price for sales of C to X = 964,000/ 1,000 = 964 /model A

Cost Plus Method

CP method begins with the costs incurred by a supplier of a product or service provided to an associated enterprise, and a comparable gross mark-up is then added to those costs. This comparable gross mark up is determined by :

Internal Comparable Transaction

Where the cost plus mark up of the supplier in the controlled transaction is determined by the cost plus mark-up realized for these items between one party to the controlled transaction and an independent enterprise in a comparable uncontrolled transaction, or

External Comparable Transaction

Where the cost plus mark up of the supplier in the controlled transaction is determined by the cost plus mark unrealized between two independent enterprises none of which is party to the controlled transaction in a comparable uncontrolled transaction.

The Cost of Production is the starting point for this method. Comparability of COP is necessary for comparison. Traditional Financial Accounting Systems do not capture such cost, neither provides guidelines for arriving at such cost leading to different bases being adopted by companies. For this Cost Accounting Standard (CAS) is the only imperative which gives a firm data base for such analysis .ICAI has issued such standard and CMAs are best equipped to formulate and certify such benchmarking which arise under the CP method as a result of accounting practices inconsistency—where the supplier in the controlled transaction treats a particular cost item as an indirect cost (i.e. this cost item is accounted for as part of the cost of sales), while the supplier in the selected comparable uncontrolled transaction treats the same cost item as an operating expense (i.e. this cost item is not subtracted at the gross profit level). In such a case, and assuming that the aforementioned accounting practice difference is the only difference between the two transactions, the gross profit in the comparable uncontrolled transaction tends to be higher than the gross profit in the controlled transaction.

Transaction Net Margin Method (TNMM)

This method was recommended by OECD in response to US Comparable Profits method (CPM). Comparing the net profit margin relative to an appropriate base such as costs, sales or assets realized by the taxpayer in a controlled transaction with the net profit margin realized by the same taxpayer, or by an independent enterprise in a comparable uncontrolled transaction, NP margin with Associate Enterprise established based on cost incurred sales effected, assets employed, etc.

NP margin in uncontrolled transaction is calculated based on the same criteria.

NP margin in uncontrolled transaction situations is adjusted to factor open market issues.

NP margin of AE transaction established / compared with uncontrolled Transaction NP.

While CP and RP methods compare gross profit margins, TNMM compares net profit margins TNMM on a transactional basis and not on a companywide basis.

Profit Split Method

The Profit Split Method seeks to eliminate the effect on profits of special conditions made or imposed in a controlled transaction by determining the division of profits that independent enterprises would have expected had it undertaken the transaction.

Steps for the application of the profit split method:

The first step is to determine the total profit earned by the firm from a controlled transaction, not the total profits of the group as a whole.

This is generally the operating profit, before the deduction of interest and taxes.

The second step is to split the profit between the parties based on the relative value of their contributions to the controlled transactions, considering the functions performed, the assets used, and the risks (FAR) by each party in the controlled transaction, in relation to what independent parties would have received, ie benchmark with independent transactions and allocate profit on that basis.

The total profit could be allocated using one of the following approaches:

1. Contribution Analysis Approach **:** where the total operating profit from a controlled transaction is divided between the associated enterprises based upon the relative value of the functions performed by each of the associated enterprises participating in the controlled transaction, supplemented as much as possible by external market data that indicate how independent enterprises would have divided profits in similar circumstances.

2. Residual Profit Split approach **:** where the operating profit of the controlled transactions is divided between the associated enterprises.

This process is carried out in two stages:

(a) Each of the parties to the controlled transaction is assigned a return to the basic functions that it performs (e.g. manufacturing or distribution). Ordinarily, this basic return is to be determined by benchmarking to market returns achieved for similar types of transactions by independent enterprises.

(b) The residual profit remaining after the first stage division would be allocated among the parties based on an analysis as to how this residual would have been divided between independent enterprises. Indicators of the parties' contributions of intangible property could be particularly useful in this context.

X and Y are two associated enterprises in two different tax jurisdictions. Both manufacture the same product. Both these companies make expenditure for the creation of an intangible asset which both the companies use to promote the product. X and Y exclusively sell products to third parties. (it is also assumed that intangible cost is for the first year and these is no prior expenditure on this intangible). It is presumed that Profit Split is the best applicable method. On market analysis of uncontrolled transactions, it is seen that such transactions earn a return of 10% of the Cost and that the residual profit should be split in proportion to X and Y intangible asset expenditure.

	X	Y	X+Y
Sales	100	300	400
Cost as per CAS14	60	95	155
Gross Profit	**40**	**205**	**245**
Intangible asset exp	10	40	50
Operating profit	**30**	**165**	**195**
Return on similar transaction with uncontrolled entities	12	19	31
Residual Profit to be split	18	146	164
Intangible expenditure basis of Residual Profit Split	32.8	131.2	164
Profit for ALP	44.80	150.20	195.00
Additional revenue as per ALP	14.80		

Global Formulary Apportionment Method (GFA)

This method is not accepted by OECD countries as well as Indian Taxation regulations as a valid method of arriving at ALP.

A global formulary apportionment method allocates the global profits on a consolidated basis among the associated enterprises in different countries on the basis of a predetermined formula.

There are three essential steps to apply a global formulary apportionment method :

1. Determining the unit to be taxed in including AE
2. Determining the global profits
3. Establishing the formula to be used to allocate the global profits of the unit. This formula is to be based on combination of costs, assets, payroll, and sales.

The GFA allocates the total profits of the group between parties on the basis of an arbitrary predetermined formula, based on weighing of relative labor costs, relative capital employed, and/or other relative factors. By contrast, the profit split method seeks to allocate the integrated profits of a transaction on the basis of the actual relative contributions of the parties to the profit in light of what comparable independent enterprises would have sought to achieve in comparable circumstances. Thus it seeks to establish a more objective measure of each of the parties' profit.

CAS6 also lists out the same methods for Tangible Transactions and the appropriate methods for Intangibles. CAS 6 indicates that, for intangibles, CUP or Resale Price method would be appropriate. Where transfer of highly valuable intangible is involved profit based method (Profit split method or Transactional Net Margin method) is more appropriate.

Sec. 92C of the Income Tax Act stipulates Computation of Arm's Length Price by applying the 'most appropriate' method out of

1. Comparable Uncontrolled Price (CUP)
2. Resale Price Method (RPM)
3. Cost Plus Method (CPM)
4. Transaction Net Margin Method (TNMM)
5. Profit Split Method (PSM)

CAS 6 issued by ICAI provides guidelines on the above.

As per Income Tax Act, most appropriate method referred above shall be applied, for determination of arm's length price

Options under proviso to Section 92 C (2)

Where more than one price is determined by the most appropriate method the ALP shall be taken to be the arithmetical mean of such prices.

OR

If the variation between the ALP so determined and price at which the international transaction has actually been undertaken does not exceed five per cent of the latter, the price at which the international transaction has actually been undertaken shall be deemed to be the arm's length price.

(Amended by the Finance (No. 2) Act, 2009)

[Section 92C].

The Finance Bill 2011 had proposed that instead of a variation of 5 percent, the allowable variation would be such percentage as may be notified by Central Government in this behalf. The Finance Bill 2012 has provided an upper ceiling of 3 percent as the tolerance range for determination of the ALP.

The same shall be effective from 1 April 2013, and shall apply in relation to FY 2012-13 onwards.

Comparability and Benchmarking key to Transfer price

The principle of comparability is fundamental in the determination of arm's length transfer prices. This is due to the fact that the price or profit of an uncontrolled transaction is used as a benchmark against which the price or profit of a controlled transaction is to be evaluated. The comparison conducted between controlled and uncontrolled transactions on the degree of similarity particularly in regard to the characteristics of the property or services transferred, and the functions performed in each of the transactions taking account of the assets used and risks assumed, is very critical in arriving at the Arms Length Price, and adjustments, if any, have to be carried out for comparability in arriving at ALP.

In a recent case relating to Sapient Corporation Pvt Ltd the Delhi Bench of ITAT ruled that if loss making comparables are excluded from comparison, comparables with superprofits will also have to be excluded from comparison. The decision reteriorates the importance of proper FAR analysis for the purpose of ensuring that functional comparability is the primary basis of selection of comparable companies.

The OECD Transfer Pricing Guidelines describe the following as the major factors determining comparability :

1. Characteristics of Property or Services

According to the OECD Transfer Pricing Guidelines, the most important characteristics to be examined in analyzing this factor include, but are not limited to, the following :

(a) In the case of transfers of tangible property:
- Physical features of the property
- Property quality and reliability, and
- Property availability and volume of supply.

(b) In the case of provision of services:
- The nature and extent of the services.

(c) In the case of intangible property:
- Form of transaction (e.g. licensing or sale)
- Type of intangible (patent, trademark, or knowhow)
  — Duration and degree of protection, and
  — Anticipated benefits from the use of the property.

2. Functional Analysis

Functional analysis is an analysis of the functions performed (taking into account assets used and risks assumed) by associated enterprises in controlled transactions and by independent enterprises in comparable uncontrolled transactions.

Three main aspects in any transaction is analysed in functional analysis :

- ➢ Functions undertaken by each party to a transaction and the economic significance of such functions
- ➢ Assets (both tangible and intangible) employed by each party to that transaction
- ➢ Risks borne by each party to that transaction.

3. Contractual Terms

Contractual terms play in defining, explicitly or implicitly, how the responsibilities, risks, and benefits are to be divided between the parties in a particular transaction.

Contractual terms include :

- ➢ Sales or purchase volume
- ➢ Working Capital
- ➢ Financing—direct / indirect
- ➢ Collaterals for transactions
- ➢ Contract duration
- ➢ Delivery terms
- ➢ Credit and payment terms
- ➢ Terms governing the provision of warranties
- ➢ Terms governing the right to updates, or modifications
- ➢ Terms allocating the different risks, such as the exchange rate risk, inventory risk, etc.

4. Economic Circumstances

Economic factors are recommended by the OECD Transfer Pricing Guidelines to be considered in measuring

- ➢ market comparability
- ➢ Geographic location
- ➢ Size of the markets
- ➢ Extent of competition in the markets and the relative competitive positions of the buyers and sellers
- ➢ Credit Terms
- ➢ Availability of substitute goods and services
- ➢ Levels of supply and demand in the market as a whole and in particular regions
- ➢ government regulation of the market
- ➢ Costs of production, including the costs of land, labor, and capital
- ➢ Transport costs
- ➢ Level of the market (e.g. retail or wholesale)
- ➢ Date and time of transactions
- ➢ Business, economic and product cycles; etc.

5. Business Strategies

Business strategies must be examined in determining comparability for transfer pricing purposes.

Business strategies would take into account many aspects of an enterprise, such as innovation and new product development, degree of diversification, risk aversion, assessment of political changes, input of existing and planned labour laws, duration of arrangements, and other factors bearing upon the daily conduct of business. Such business strategies may need to be taken into account when determining the comparability of controlled and uncontrolled transactions and enterprises.

Documentation requirement to be fulfilled by the company as per Sec. 92D of Income Tax Act and Rule 10D of Income Tax Rules

Documentation requirement to be fulfilled by the company as per Sec. 92D of Income Tax Act and Rule 10D of Income Tax Rules :

(a) a description of the ownership structure of the assessee enterprise with details of shares or other ownership interest held therein by other enterprises.

(b) a profile of the multinational group of which the assessee enterprise is a part along with the name, address, legal status and country of tax residence of each of the enterprises comprised in the group with whom international transactions have been entered into by the assessee, and ownership linkages among them.

(c) a broad description of the business of the assessee and the industry in which the assessee operates, and of the business of the associated enterprises with whom the assessee has transacted.

(d) the nature and terms (including prices) of international transactions entered into with each associated enterprise, details of property transferred or services provided and the quantum and the value of each such transaction or class of such transaction.

(e) a description of the functions performed, risks assumed and assets employed or to be employed by the assessee and by the associated enterprises involved in the international transaction.

(f) a record of the economic and market analyses, forecasts, budgets or any other financial estimates prepared by the assessee for the business as a whole and for each division or product separately, which may have a bearing on the international transactions entered into by the assessee.

(g) a record of uncontrolled transactions taken into account for analysing their comparability with the international transactions entered into, including a record of the nature, terms and conditions relating to any uncontrolled transaction with third parties which may be of relevance to the pricing of the international transactions.

(h) a record of the analysis performed to evaluate comparability of uncontrolled transactions with the relevant international transaction.

(i) a description of the methods considered for determining the arm's length price in relation to each international transaction or class of transaction, the method selected as the most appropriate method along with explanations as to why such method was so selected, and how such method was applied in each case.

(j) a record of the actual working carried out for determining the arm's length price, including details of the comparable data and financial information used in applying the most appropriate method, and adjustments, if any, which were made to account for differences between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions.

(k) the assumptions, policies and price negotiations, if any, which have critically affected the determination of the arm's length price.

(l) details of the adjustments, if any, made to transfer prices to align them with arm's length prices determined under these rules and consequent adjustment made to the total income for tax purposes.

(m) any other information, data or document, including information or data relating to the associated enterprise, which may be relevant for determination of the arm's length price.

The above documentation requirements is not mandatory where the aggregate value, as recorded in the books of account, of international transactions entered into by the assessee does not exceed one crore rupees.

Advance Pricing Agreement (APA) under Transfer Pricing Regulations in the Union Budget of year 2012-13

An APA is an agreement between a taxpayer and at least one tax administration on an appropriate transfer pricing methodology for a related party transaction. This agreement applies over a fixed period of time. Unilateral APA is an agreement between a taxpayer and the tax administration of the country where it is subject to taxation. A bilateral or multilateral APA is between the taxpayer, the tax administration of the country where it is subject to taxation and one or more foreign tax administrations.

The introduction of Advance Pricing Agreement (APA) under Transfer Pricing Regulations in the union budget of year 2012-13 is a positive step to reduce the litigation as it will be based on bilateral understanding between two countries wherein it has been proposed to be valid for a maximum of consecutive 5 years unless there is a change in provisions of the Code having a bearing on the international transaction.

It is pertinent to note that unilateral APAs are not recognised by a foreign tax authority and, thereby, the risk of double taxation would still exist, if the foreign tax authority does not agree with the method of computing the arm's-length price (ALP).

However, in case of bilateral / multilateral APAs, all the tax authorities involved in the covered transactions including the Indian and foreign tax authorities agree to the ALP of the covered transaction and, thereby, the MNCs avoid the burden of double taxation.

Introduction of the APA legislation would bring about certainty, clarity of opinion, and other benefits to corporate India. The APAs offer better assurance on transfer pricing methods and are conducive in providing certainty and unanimity of approach.

Strategic Implications of setting of Proper Arms Length Price

For any decision of investment the Tax liability of the principal outside India and the tax liability of the company in India needs to factor in the Transfer Pricing regulation in force to avoid future legal tussles and also to protect the profitability envisaged in the viability of the proposals. These needs to be examined in details during assessment of the viability of the project itself along with cost management tools to fine tune the tax strategy with the costing of the product and transfers.

Bombay High Court, in case of SET Satellite (Singapore) Pte Ltd (218 CTR 452), in line with the Supreme Court decision in Supreme Court judgement in case of DIT (Intl Taxation) vs. Morgan Stanley and Co Inc (292 ITR 416) has held that if the correct arm's length price is applied and paid, then nothing further would be left to be taxed in the hands of the foreign enterprise. The Bombay High Court has restored the CIT(A) order in the taxpayer's case and held that in case the agent is remunerated at arm's length by the foreign principal, the tax liability of the foreign principal (which would arise in case it is regarded to have a PE in India) would stand extinguished.

Where the transactions are held to be at arm's length, nothing further can be attributed to the PE, provided that the transfer price takes into account all the risktaking functions of the foreign enterprise. Thus, assessment of PE gets extinguished only if the following two conditions are cumulatively met :

The associate enterprise has been remunerated on arm's length basis, and **By FAR (Functions performed, Assets utilised and Risks assumed)** analysis of Indian and foreign enterprise.

Nothing more can be attributed to PE liability of foreign company in India and may not be extinguished unless the transfer pricing takes into account the FAR analysis of Indian company as well as foreign company.

This needs to be kept in perspective while arriving at Arms Length Price of Permanent Establishments in India, otherwise the Revenue Department may could attempt to attribute profits to a PE transfer pricing documen-tation should be maintained and benchmarking should be done in a manner whereby the Functions performed, Assets utilised and Risk assumed (FAR) of both the foreign entity and Indian entity are taken into account.

Tax rate differential exists between countries and companies take that into account during their astute tax planning process. Improper Tax planning vis-a-vis tax liability on transfer pricing can lead to margins going hayware as companies in these days of intense competition operate in wafer-thin margins only.

Role of CMA and ICAI in Transfer Pricing

ICAI has issued Transfer Pricing Guidelines in 2002. The Cost Accounting Standards 1-4 issued by ICAI has great relevance is arriving at ALP in Transfer Price :

CAS No.	Title	Details
CAS1	Classification of Cost	For preparation of Cost Statements
CAS2	Capacity Determination	For determination of capacity
CAS3	Overheads	For Collection, Allocation, Apportionment and Absorption of overheads
CAS3 (Revised 2011)	Overheads	To bring uniformity and consistency in the principles and methods of determining the Overheads with reasonable accuracy
CAS4	Cost of Production for Captive Consumption	To determine the assessable value of excisable goods used for captive consumption

All the Five methods mandated by Income Tax Act, India, requires as an input detailed cost accounting data / information, especially in respect of adjustments to be incorporated with respect of controlled and uncontrolled transactions to make them comparable to arrive at the ALP. Financial Accounting system does not capture the data or give the information Product-wise, Cost poolwise,Cost driverwise, Cost centerwise neither the financial audit checks the veracity of the same, it concentrates on proper booking of expenditure and proper representation in Final Accounts focused on investors.

However, the regulatory requirements, specially with regards to Transfer Pricing, cannot be met by Financial Accountants. This requires proper cost accounting system and the information generated needs validation by conducting Cost Audit by CMAs. The Revenue administration as well as the companies will find such information handy in dealing with Transfer Pricing decisions.

Presently this data is not readily available—

(contd. to page 527)

International Transfer Pricing : The Current Landscape in India

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Introduction

Multinational corporations (MNCs) are not new phenomenon, but since the World War II (1939-1945), their spectacular rise has considerably reshaped both the global economy and the world politics (the political roles played by some American MNCs in the 1970s may be recalled). With the intensifying force of globalization, the influence of the MNCs in the world economy has further deepened so much that 80% of the world's industrial production is said to be generated by 1,000 largest MNCs and as much as one third of the total US international trade is conducted by and within US owned MNCS by means of intercompany transactions (Truitt, 2006 : p.161). By some recent estimates, MNCs' production worldwide generated value-added of approximately $16 trillion in 2010, about a quarter of global GDP, while the foreign affiliates of MNCs accounted for more than 10 per cent of global GDP and one-third of world exports (UNCTAD, 2011). If we add to this figure the trade that takes place between MNCs and other unaffiliated firms (which are, more often than not, non-equity modes of international production by the MNCs), which accounted for $2 trillion in international sales in 2010, then MNCs are involved in about two-thirds of world trade (UNCTAD, 2011; Wittendorff, 2010). No doubt that these MNCs are the keystone of the global economic edifice and they will surely maintain that position in the global village that the world is now. Because of their unique position and core competencies these MNCs are able to coordinate their activities within a global value chain either through their direct supervision and control—leading to cross border FDI —or through non-equity mode of production in a contractual arrangement but nonetheless exercising relative bargaining power over those host-country firms.

While the ultimate ownership and control configuration of a global value chain is the outcome of a set of strategic choices by the MNC—the relative costs and benefits, the associated risks, the feasibility of available options and legal barriers in the host country, for example—it oversees a sequence of activities from procurement of inputs, through manufacturing operations to distribution, sales and after-sales services. In addition, firms undertake activities—such as IT functions or R&D—which support all parts of the value chain (UNCTAD 2011).

Pricing Conundrum

One of the most difficult, and controversial as well, areas in the relationship between the MNCs and their overseas subsidiaries has been the pricing issue of the goods, services and technologies used in the production and distribution of cross-border transaction of goods and services.

Indeed, the plethora of literature on the subject has identified intercompany pricing of goods and services as one of the most significant and perplexing issues faced by the MNCs (Weekly 1992; O' Connor, 1997). Such intercompany pricing is also used as a vehicle to achieve several other objectives such as:

- Moving funds internationally
- Minimizing tariffs
- Avoiding exchange control quotas
- Minimizing exchange risks
- Increasing share of profits from joint ventures
- Optimizing managerial incentives and performance evaluation; and
- Minimizing taxes.

The bare-bones of the aforesaid objectives influencing MNC pricing policy, more specifically referred to as 'transfer pricing issues', are well-discussed in O'Connor (1997). For example, O' Connor explains that, if a MNC wants to move fund out of a country, it can charge higher price to its foreign affiliate, or can do the opposite when the objective is to supply fund to the affiliate. Similarly, affiliates wishing to pay lower import duty may follow low mark-up policy. If the MNC under-prices the shipment of goods to the foreign affiliate, it can effectively offset the volume effects of exchange quotas. Exchange rate fluctuation is a zero-sum game in the sense that loss of one party results in gain to the other party by equal measure; but depending on the accounting treatments and tax laws of the respective party it can have different effect on different party. The profits from a joint venture similarly can be made to vary depending on the transfer price charged to the affiliates. When firms are organised as decentralized profit centres, transfer pricing between centres can be a major determinant of corporate performance.

Since MNCs and their affiliates are located in different tax jurisdictions having different tax rates, transfer pricing is also influenced by tax considerations (Feinschreiber and Kent, 2003). Income tax payments are significant costs for most MNCs and transactions between affiliated entities are an important part of these income tax exposures (ibid).

In a typical situation, where tax rates are same in two countries, no special advantage accrues to the MNCs from tax minimization perspective from one mark up policy than the other. But when the tax rates are different, the MNCs are likely to pursue a high mark up policy in order to shift profits from a higher to a lower tax jurisdiction. Quite logically, in an increasingly globalized economy, the decisions of governments regarding corporate taxation affect the decisions of multinational firms regarding where to locate economic activity and where to book profits (Clausing, 2009). This, in turn, affects the governments, leaving a wide chasm in terms of revenue they get and what they would have got in a tax-neutral situation.

The problem of lost revenues from taxation is further aggravated by the incidences of ''Tax Havens'', which, in combination with low rates of taxes (sometimes no tax at all) help the unscrupulous enterprises to avoid taxes by means of various subterfuges. These tax havens have in the recent past risen to the fore of the fiscal policy debate and have been identified as one of the root causes of many of the shortfalls plaguing the governments of the world. These tax havens had become the major plank of President Clinton's 1992 presidential campaign as he wanted to ensure that foreign investors pay their fair share of US taxes (Kaufman, 1998). A recent study (Clausing, 2009), which sought to show the implications of tax avoidance on the US economy, revealed that between 1982 and 2004, income shifting incentives in the tax havens cost the U.S. government approximately 35 percent of corporate income tax revenues, involving an amount in excess of $ 60 billion in 2004. According to another source, the 50 largest companies in the FTSE 100 were depriving the UK Treasury of approximately £11.8 billion and global tax revenue lost to tax havens exceeded US$255 billion per year (see Wikipedia article on Tax Haven).

There are number of tax havens around the world, but the Cayman Islands—a tiny British dependency of some 54,000 population in the Caribbean Sea—has come to the fore in connection with a tax dispute between the Government of India and Vodafone International Holdings B.V. The tax dispute, which involved intricate chain-holdings of several international and Indian companies, boils down to the right of the Indian Government to tax an overseas transaction between three foreign entities, namely the Vodafone International holdings (resident for tax purposes in the Netherlands), CGP Investments (Holdings) Ltd., (a company resident for tax purposes in the Cayman Islands) and The Hutchison Group (Hong Kong-based). In a merger / acquisition type of deal between Vodafone and Hutchison group in the Cayman Island-based CGP Investments, the underlying assets of one Indian company also got transferred to Vodafone International. The Government of India slapped a Rs. 12,000 crores tax notice on Vodafone, but in a wending course of protracted legal battle the Indian Apex Court gave verdict in favour Vodafone, reversing the earlier judgment of the Bombay High Court favouring the Indian Government. No doubt the judgment of the Supreme Court is in consonance with the strict interpretation of the language used in the Income-tax Act, 1961, but to get at the nub of things (which could not have been done under the existing provisions due to the unforeseen limitations of legal wordings) the Government has made amendments to the Act retrospectively from 1962, inviting scathing attack from the media as well as from the Industry. While the Vodafone issue could be a topic of healthy academic debate, in the context of tax haven, the identity and the ''reputation'' of the Cayman Islands needs some elaboration.

In the recent past this tax haven was the subject of an investigation by the United States Government Accountability Office (GAO, 2008) entailing the enforcement challenge for the US tax authorities. The report of the GAO, among several other things, provides some interesting facts about one Ugland House—a tiny building owned by Maples and Calder, a law firm and company-services provider that serves as registered office for the 18,857 entities it created as of March 2008 on behalf of a largely international clientele. The Report also mentioned that 96 percent of those entities were exempt companies, exempt limited partnerships, and exempt trusts. They were prohibited from trading in the Cayman Islands with any persons, firm, or other corporation except in furtherance of their business that is carried on outside the Cayman Islands. Needless to mention that Cayman

Islands and its ilk are the causes of headaches for the governments throughout the world, inviting stricter enforcement mechanism in the form of transfer price regulations and General Anti Avoidance Rule (GAAR).

Arm's length principle for Transfer Pricing

As globalization continues to make inroad into the global economy, the fiscal authorities all over the world are getting increasingly concerned to get their legitimate share of tax revenue from MNC activities in their territories. The OECD Guidelines for Multinational Enterprises (OECD, 2008), therefore, required the MNCs to provide the relevant authorities the information necessary for the correct determination of taxes to be assessed in connection with their operations and conforming transfer pricing practices to the arm's length principle.

Arm's length pricing (ALP), which is now an international consensus, is a method of stripping the possible camouflage embedded in the transfer pricing. It is set forth in Article 9 of the OECD Model Tax Convention as :

Where ''conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly'' (OECD, 2010).

Simply stated, ALP is the price for the hypothetical transaction, which the associated enterprises would have agreed if they would have made comparable transactions on the open market rather than the controlled transaction that was in fact made. The arm's length principle involves a valuation of controlled transactions where the yardstick is the market transaction. Transfer pricing, therefore, demands a critical economic analysis to show how transfer price has been determined and to substantiate that it complies with the arm's length principle. It is, in fact, an exercise in comparability which is at the heart of transfer pricing. The question usually revolves around the factors that determine the tested transaction and how these can be compared with the independent but equivalent situations observed between arm's-length parties (Zetter et al, 2009).

From the point of view of taxation policy the choice of arm's length principle is justified by the fact that it contributes tax equality and neutrality between the associated enterprises and an independent enterprise. The principles of equality and neutrality are the core values of the tax law and constitute the basis for tax treatment of corporate group formations (Wittendorff, 2010). Because the arm's length principle puts associated and independent enterprises on a more equal footing for tax purposes, it should promote the growth of international trade and investment and thus lead to fair international income allocation.

Transfer Pricing Techniques

Although the law relating to transfer pricing is different in different countries, they have large degree of similarity with the OECD guidelines, and irrespective of the minor differences, they all aim at achieving a comparability test for the transactions between the MNCs and the associated enterprises. Indeed, the OECD has reiterated its principles that when transfer pricing does not reflect market forces and the arm's length principle, the tax liabilities of the associated enterprises and the tax revenues of the host countries could be distorted. Therefore, OECD member countries have agreed that for tax purposes the profits of associated enterprises may be adjusted to correct any such distortions and thereby ensure that the arm's length principle is satisfied (OECD, 2010: p. 32). Accordingly, the OECD has devised a number of methods for transfer pricing with a view to achieving arm's length price. However, it is important to bear in mind that the need for the aforesaid adjustments to approximate arm's length transactions arises irrespective of any contractual obligation undertaken by the parties to pay a particular price or of any intention of the parties to minimize tax. Thus, a tax adjustment under the arm's length principle would not affect the underlying contractual obligations for non-tax purposes between the associated enterprises (ibid : p.31).

The ''standard'' transfer pricing methods include the following :

- ***Comparable Uncontrolled Price (CUP) Method*** **:** The OECD (2010) has defined this method as that ''compares the price for property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction in comparable circumstances''. CUP, by its very definition, contemplates an observable market price for the property and services in question. Therefore, as long as this condition is fulfilled, this is the most direct and reliable way to apply the arm's length principle. The method is commonly used to calculate arm's length interest rates on intercompany loans.

- ***Cost-plus Method*** **:** This method involves selection of comparable business and calculation of an appropriate profit as a mark-up on the cost inputs of the representative firm. According to the OECD, this method is likely to be most useful where semi-finished goods are sold between associated parties, where associated parties have concluded joint facility agreements or long-term buy-and-supply arrangements, or where the controlled transaction is the provision of services.

- ***Resale Price Method*** **:** The OECD has defined it as a transfer pricing method based on the price at which a product that has been purchased from an associated enterprise is resold to an independent enterprise. The resale price is reduced by the resale price margin. What is left after subtracting the resale price margin can be regarded, after adjustment for other costs associated with the purchase of the product (e.g. custom duties), as an arm's length price of the original transfer of property between the associated enterprises.

- ***Profit Split Method*** **:** This method is mainly applicable in international transactions involving transfer of unique intangibles or in multiple international transactions which are so interrelated that they cannot be evaluated separately for the purpose of determining the arm's length price of any one transaction. Under such circumstances the profits split method identifies the combined profit to be split for the associated enterprises from a controlled transaction and then splits those profits between the associated enterprises based upon an economically valid basis that approximates the division of profits that would have been anticipated and reflected in an agreement made at arm's length.

- ***Transactional Net Margin Method*** **:** As a variant of the profit split method, this method examines the net profit relative to an appropriate base (e.g. costs, sales, assets) that a taxpayer realizes from a controlled transaction. The net profit margin realized by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is also computed and this is taken into account to arrive at an arm's length price in relation to the international transaction with the associated enterprise.

- ***Unspecified Methods*** **:** Apart from the ''standard methods'' described above, the literature on international transfer pricing has identified a multiplicity of other methods to arrive at arm's length price. Such methods attempt to provide information on the prices or profits that the controlled entities could have realized by choosing a realistic alternative to the controlled transaction.

Advance Pricing Agreements and Safe Harbours

While the concept of arm's length pricing is well-accepted both by the multinational taxpayers and the taxing authorities around the world, the fact remains that it is fraught with several practical obstacles. The rules relating to the ALP are not only different in different countries, but also the methodologies behind the ALP are not straightforward and, therefore, not amenable to unique interpretations by the tax payer and the tax collectors. In theory, ALP intends to look to the identical transaction under the same circumstances between uncontrolled entities. But in reality such identicalness rarely exists. As a practical matter, therefore, the determination of ALP, more often than not, is based on ''comparable transactions'' under ''comparable conditions'', making it more of a fact-intensive process and judgmental in nature. In the process, the difference in perceptions and economic assumptions lead to disputes and harsh transfer pricing audits from the aggressive Revenues which are vying with each other to aggrandize its fair share of ''legitimate tax''. Countries which are noted for such aggressive transfer pricing policies include, in order of rank, Japan, India, China, Canada and the US (KPMG, 2011). For instance, at the end of the sixth cycle of transfer price audit in India, the Income-tax Department has made transfer price adjustments to the extent of INR 20,000 crores. If all the six transfer price audits conducted since its inception in 2003 are taken into consideration, the cumulative value of the adjustments would be well above INR 50,000 crores (PWC, 2011). The worst part of the story is that more than 99 per cent of these cases—that also involve disputes relating to royalty payments to principals—are under litigation. These include some of the top global companies such as Microsoft, Hindalco, Maruti, GE Capital and Oracle.

The hazardous procedure of ALP also carries with it huge penalties for non-compliance—ranging between 40-50 percent of the tax due in the case of United States; and at least 2 percent of the international transactions in the case of India. Due to such inherent risk of ALP, in 1991 Apple Computer became the first company which entered into an advance pricing agreements with two tax authorities, the United States and Australia, to determine how its related party transactions should be valued for tax purposes (O'Connor, 2011). In the same year, the United Sates adopted formal advance pricing procedures on transfer pricing, which was soon emulated by Japan, the UK, Canada, Mexico, Australia, Germany, and some Scandinavian countries. Since then both the number of countries and the number of companies entering into APA agreements have been rising steadily. As of now, more than 900 companies have entered into advance pricing agreements in the United States. The corresponding number of advance pricing agreements in Japan is about 600, 350 in Australia, 250 in China and 150 in Canada (KPMG, 2011). With the rising number of transfer pricing disputes and the escalating tax war among the nations, advance pricing agreements are fast becoming the new order of the international transfer pricing regime.

An APA is basically a contractual arrangement with the tax administration of one or more countries to resolve potential tax disputes in an amicable and cooperative manner. The OECD (2010) has defined the term as ‘‘An arrangement that determines, in advance of controlled transactions, an appropriate set of criteria (e.g. method, comparables and appropriate adjustments thereto, critical assumptions as to future events) for the determination of the transfer pricing for those transactions over a fixed period of time’’. According to the Internal Revenue Service (USA), APAs are designed to resolve actual or potential transfer pricing disputes in a principled, cooperative manner, as an alternative to adversarial process. It is a binding contract between the taxpayer and the tax administration of one or more countries (unilateral APA and multilateral APA) by which the latter agrees not to seek transfer pricing adjustments for a covered transaction, provided that the taxpayer follows the agreed transfer pricing method.

APAs have several advantages over the traditional transfer pricing system. From the taxpayers’ point of view, it eliminates the uncertainty, provided the critical conditions are met. In the uncertain world of transfer pricing, it provides certainty to help the tax payer with a definite tax outcome and liability. As against the predatory transfer pricing ambience, it promotes a non-adversarial spirit and environment between the taxpayers and the tax administration, leading to free flow of information for mutual benefits. Costly and time-consuming examinations and litigation of major transfer pricing issues for taxpayers and tax administrations may also be avoided.

Bilateral and multilateral APAs substantially reduce or eliminate the possibility of juridical or economic double or non taxation since all the relevant countries participate in the process.

But APA is not without its pitfalls. It is a time-consuming process and can take significant amount of time and resources as compared to a tax audit. A unilateral APA may sometimes take 12 to 18 months, while a bilateral APA may involve more than 24 months. Obviously, such an arrangement may not be suitable for small organizations and non-repetitive nature of transactions. In contrast to APA, which is a taxpayer-specific arrangement, safe harbour is general in nature. Designed as a comfort mechanism, safe harbours provide for circumstances in which a certain category of taxpayers can follow a simple set of rules under which transfer prices are automatically accepted by the revenue authorities. According to the OECD (2010: Para 4.94), ‘‘a safe harbour is a statutory provision that applies to a given category of taxpayers and that relieves eligible taxpayers from certain obligations otherwise imposed by the tax code by substituting exceptional, usually simpler obligations’’. The positive aspects of safe harbour include certainty with respect to tax obligations and administrative simplicity. But the most important aspect of safe harbour is of course compliance relief for a designated class of taxpayers who may be subjected to, instead of a specific transfer pricing method, a sort of presumptive tax.

Like APAs, safe harbours are also not without its flipside; it is arbitrary and it sacrifices accuracy in reporting arm's length price, but this demerit is offset against the simplicity and compliance relief that the taxpayer is accorded. It also insulates the taxpayer against the hazards of arduous transfer price audits.

Evolving Landscape of Transfer Pricing in India

At a time when India is being considered a centripetal force of globalization and MNCs are making beeline to enter the vast Indian market, especially in the lucrative sectors like multi-brand retailing, the country seems to be caught between the devil and the deep blue seas over its transfer pricing policies. The Vodafone case is not just an isolated issue, but the general uncertainty over international tax matters is manifest in the fact that at least INR 30,000 crores of tax revenues involving some 1,200 companies are locked in transfer pricing litigations pending before courts, income-tax tribunals and tax appeal commissioners. India now has the dubious distinction of having the most international transfer price disputes. However, the recent developments in transfer pricing matters are seen as a bellwether of change of India's ramshackle transfer pricing policy.

Although India’s foray into a systematic international transfer pricing policy is traced to the Finance Bill, 2001, its attempt towards tackling the transfer pricing problems can be traced far back into the Income-tax provisions contained in the Act of 1922. Section 42(2) of the said Act, which corresponded to Section 92 of the Income-tax Act of 1961, dealt with the provisions relating to computation of income from transaction with non-residents. In Mazagoan Dock Ltd v. CIT [34 IT 3368], in which two non-resident shipping companies entered into an agreement with a resident company for providing repair services to the parent bodies free of cost, was held by the Supreme Court to be the income of the resident company (See Palkhivala and Palkhivala, 1990 : pp. 1004-05). Section 92 of the Income-tax Act, 1961 (the old section before it was replaced by the new Section 92 w.e.f. the assessment year 2002-03), which was a transmutation of section

42(2) of the old Act, brought about similar charges to the resident assessee and required the Assessing Officer to ‘‘determine the amount of profits which may reasonably be deemed to have been derived there from’’. The transfer pricing provisions (if it can be at all called by that name at this juncture) under the old provision of the Act was no better than the guesstimates of the Income-tax department. However, in line with the global trend, India made a new beginning with its transfer pricing policy when it was carved out of the OECD guidelines and codified as law by the Finance Act, 2001 (effective from the assessment year 2002-03). The said Finance Act replaced the old Section 92 and in its place inserted a new Chapter X, containing eight sections, into the Income-tax Act 1961(viz. Sections 92, 92A, 92B, 92C, 92CA, 92D, 92E and 92F). Subsequent developments include some major changes made in the Income-tax Act in 2009 and in 2012. With these developments, India now has more or less comparable transfer pricing mechanism.

An overview of the Indian transfer pricing mechanism is presented :

- ***Arm’s length pricing*** **:** Effective from the assessment year 2002-03, the sections mentioned in the parenthesis above have been added to the Income-tax Act to delineate the arm's length pricing system for international transactions. Section 92 requires every assessee to compute income arising from international transactions with associated parties on the basis of arm's length price. Section 92A defines exhaustively the meaning of associated parties, while the meaning of international transactions is defined in Section 92B, which covers five types of transactions: loans or advances; performance of personal services; use of tangible property; transfer of / use of intangible property; and sale / purchase / lease of tangible property. The methods of computation of arm's length price contained in Section 92C are in conformity with the ‘‘standard methods’’ mentioned earlier. The Central Board of Direct Taxes (CBDT) has framed detailed Rules (Rule 10A, 10B and 10C) to define and determine arm’s length price under Section 92C.

Transfer pricing in India requires an elaborate system of information and record keeping. The requirements of Section 93D, read with Rule 10D, are stringent enough. Also, an accountant’s report detailing the international transactions entered into by the assessee is to be furnished in accordance with the requirements of Section 932E, Rule 10E and Form No. 3CEB.

Important changes made in 2009

International transfer pricing in India is in an evolutionary stage. Finance Act, 2009, has made the following additions to the existing transfer pricing regulations “

- ***Safe Harbour Rules*** **:** with retrospective effect from the assessment year 2009-10, Finance (No.2) Act has inserted Section 92CB to provide for safe harbour rules for computing arm's length price. The CBDT has been empowered to make rules, which are likely to roll out anytime soon.

- ***Dispute Resolution Panel (DRP)*** **:** Transfer pricing mechanisms, being subjective in nature, are inherently prone to disputation and prolonged litigations. To instil confidence in the foreign investors in India, Finance (No. 2) Act has inserted Section 144C to provide for alternate dispute resolution panel. As a result, unlike in the past, when the order passed by the Transfer Pricing Officer under Section 92CA was binding, Section 144C has removed the straightjacket by providing for the DRP.

As collegiums of three Commissioners of income-tax, the DRP would hear the dispute within a period of nine months. No tax demands will be raised on the taxpayer until the final order is passed by the DRP. DRP decisions are final and binding on the revenue authorities. However, if aggrieved, the taxpayer is entitled to appeal before a higher appellate authority.

Important changes made in 2012

Finance Bill 2012, which is awaiting passage, has added further momentum to the transfer pricing mechanism in India. The changes made by the Finance Bill are reflective of the resolve of the government, which is besotted with the problems of black money and tax avoidance. Important changes made here include Advance Pricing Agreements (APA) under the newly inserted Sections 92CC and 92CD; and General Anti-avoidance Rule (GAAR) under Section 95. These two issues were within the scheme of things in the proposed Direct Taxes Code (DTC), but the teething problems with the DTC still remaining unresolved, they have been included in the current Finance Bill to pre-pone implementations of these matters. The provisions of APA are more or less in conformity with those discussed above; GAAR intends to put a brake on aggressive tax planning by the foreign players as well as the domestic assessees. Under the provisions of GAAR, the tax administrations in India are accoutered with wide discretionary powers.

Conclusion

Finance Bill 2012 has made a few more amendments which have far-reaching consequences for the MNCs and transfer pricing in India. First, Sections 9 and 195 have been amended to clarify that business located in India but owned by the foreign enterprises shall be deemed to be situated in India and accordingly, sale of assets of such enterprises shall fall within the ambit of the Indian tax. As a result of retrospective amendments of these sections from 1.4.1962, Vodafone's purchase of Hutchison's stake in Vodafone India and Birla's acquisition of AT&T's stake in Idea, which were not taxable previously, would be taxable in India. Second, the clarification added to Section 9(1)(i) make payment for software acquired from abroad as a royalty. The implication of this amendment is that foreign companies supplying that software now will come within the purview of transfer pricing. Third, the amendment to Section 40A now empowers the Assessing Officers to decide on taxability of expenditure incurred in the process of transactions with the group companies. This will not only lead to higher taxes for the MNCs, but the wide discretionary powers enjoyed by the Assessing Officers will make it a potential weapon against the MNCs. But India is not alone in fleecing the MNCs. China has recently hardened its transfer pricing regulations, resulting in an explosion of transfer pricing controversies. The Canadian tax administration has asked Merck, a leader in the healthcare industry, to pay additional $660 million in taxes due to transfer price adjustments, while the company has disputed a further claim for $550 million. Hasbro, a toymaker, has faced a demand from the Mexican authorities for an extra $98 million due to transfer price adjustments. In Germany, there is a spate of transfer price audits with adverse consequences for the MNCs. The question in particular is whether transfer pricing is the low hanging fruit or not that the revenue-starved governments would bend the branch at their sweet will to grab it. This seems to be the conundrum of international taxation begging the answer from the experts. ❐

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the record requirements of the Income Tax Act leaves it to the companies to decide the principle on which it is dealt with, i.e., guidelines, basis of overhead allocation, treatment of abnormal costs, treatment of capacity utilization in overheads etc leading to non-comparability of information available.

Standardisation of Principles as started by ICAI by issue of CAS needs to adopted by regulators to have a standardised database for Transfer Pricing. In spite of all the justifications which come naturally to CMA's with respect to transfer pricing the Accountant Report to be filed in Form 3CEB cannot be done by CMA's. This needs to be taken up by revenue authorities bringing out the benefits presenting real life case studies. The revenue will be having Cost Audit, Cost Accounting records and filing return in Form 3 CEB. For Benchmarking of similar transaction which it greatly required for Transfer Pricing regulations ICAI needs to take up such exercise with Income Tax (TPO) and industry, along with input from Cost Audit Report bringing out quarterly or half yearly benchmarking reports customised for Transfer Pricing itself, making it a repository of information and will be on help to all future TP transactions. Specialised courses and training programmes need to be organised to equip CMAs with an objective of developing and updating the transfer pricing developments globally.

Conclusion

Transfer Pricing is a globally evolving area and with practice and further experience it will further be fine-tuned. Transfer pricing is not an exact science. It is a matter of judgment and finding an answer. The judgement element is bound to keep uncertainty and further scope for improved analysis. CMA's have a important role to play to make this more refined, accurate and comparable analysis and the future in this area belongs to the CMAs. ❐

Thin Capitalisation and Arm's Length Pricing

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Capital Structuring

The most important decision for financial planners in a company is with respect to the formulation of an ideal capital structure. The capital structure of any company consists of a mix of debt and equity. How much of the funds should be through equity and how much should be debt is a typical structuring decision.

Capital structure has to be determined not only at the time a company is promoted, but also later on as it requires funds from time to time.

The initial capital structure should be designed very carefully. The future structure will emerge out of the initial structure. The company will require funds to finance its activities continuously. Everytime the funds have to be procured, the pros and cons of various sources of finance have to be weighed and the most advantageous source of financing has to be selected each time. Thus the capital structure decision is a continuous ongoing decision and has to be taken whenever a company needs additional finance.

Generally, the factors to be considered whenever a capital structure decision is taken are :

(i) Leverage or Trading on equity
(ii) Cost of Funds
(iii) Cash flow
(iv) Control
(v) Flexibility
(vi) Size of the company
(vii) Sector to which the company belongs
(viii) Marketability including efficiency of financial markets
(ix) Tax considerations.

Capital structure is the composition of various sources of long-term finance in the total capitalisation of the company. These various sources of long term finance can be classified under two broad heads :

(a) Own Funds
(b) Borrowed Bunds.

Both own funds and borrowed funds including long-term loans from financial institutions are used by most of the large industrial companies. Capital structure planning—initially and on continuing basis—is of great importance to any company, as it has a considerable bearing on its profitability. A wrong initial decision in this respect may prove quite costly for the company. While deciding about capital structure, due attention should be paid to objectives like profitability, solvency and flexibility. The choice of the amount of debt and other fixed return securities on the one hand and variable income securities, namely equity shares on the other, is made after a comparison of the characteristics of each kind of securities and after careful consideration of internal and external factors related to the company's operations. In real life situations, compromises have to be made somewhere on the line between the expectations of companies seeking funds and the expectations of those that supply them. These compromises do not change the basic distinctions between debt and equity. Generally, the decision about financing is not of choosing between equity and debt but is of selecting the ideal combination of the two. The decision on debt-equity mix is affected by considerations of suitability, risk, income, control and timing. The extent of weightage that would be given to these factors will vary from company to company depending on the characteristics of the industry and the particular situation of the company. There cannot perhaps be an exact mathematical solution to the decision on capital structuring. Human judgement plays an important role in analysing the various aspects, before a decision on appropriate capital structure is reached.

High Gearing and Low Gearing

The term ''capital gearing'' or ''leverage'' normally refers to the proportion of relationship between equity share capital including reserves and surpluses to preference share capital and other fixed interest bearing funds or loans. In other words, it is the proportion between the fixed interest or dividend bearing funds and non fixed interest or dividend bearing funds. Equity share capital includes equity share capital and all reserves and surpluses items that belong to shareholders. Fixed interest bearing funds includes debentures, preference share capital and other long-term loans.

Capital Gearing can be defined as : ''The mixture of debt and equity in a firm's capital structure, which influences variations in shareholders profits in response to sales and EBIT variations.''

Formula of capital gearing ratio :

[Capital Gearing Ratio = Equity Share Capital / Fixed Interest Bearing Funds]

Capital gearing ratio is important to the company and the prospective investors. It must be carefully planned as it affects the company's capacity to maintain a uniform dividend policy during difficult trading periods. It reveals the suitability of a company's capitalization. But what it is suitable gearing in a particular case depends upon the facts and circumstances.

Apart from the financial and ''commercial'' considerations, the decision of capitalization is also greatly influenced by tax considerations. There may be situations when a company may not have access to debt based on its financial strength, but because of tax considerations may like to show and treat the finance received from its associated enterprises or related parties as its own debt to claim tax deductions. The tax authorities globally, however, have been quick to pounce upon such tax planning exercises. Different countries have made different rules to deal with such high gearing ratio. Over a period of time, the taxmen have been using the term ''Thin Capitalisation'' to refer to what finance professionals refer to as ''High Capital Gearing.''

While in strictly arms length transactions with institutional or commercial lenders, no problems are expected. What becomes relevant for financial planners and taxmen is the financing by promoters and their associated enterprises. The problem of capitalization however becomes relevant to the taxmen when securities are issued in the nature of debt, (which are in fact ''quasi equity'') and finance raised from ''promoters'' or ''associated enterprises'' for claiming interest deductions as tax benefits with the object of reducing the taxable income.

Thin Capitalization

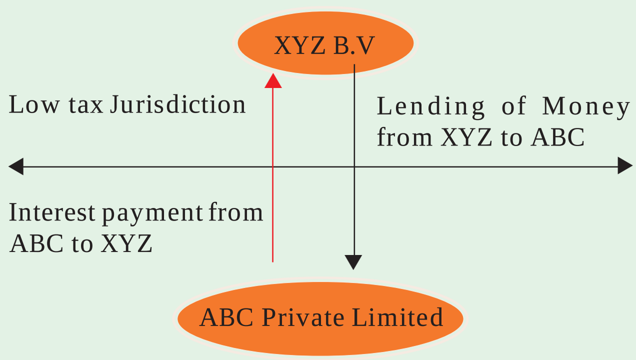
We are discussing the concept of Thin Capitalisation in the background of financing by way of ''quasi equity'' by promoters or associated enterprises and the taxmen's response to this practice.

A company is said to be thinly capitalized when its capital is made up of a much greater proportion of debt than equity, ie. its gearing or leverage, is too high. This is perceived to create problems for two classes of people :

- consumers and creditors bear the solvency risk of the company, which has to repay the bulk of its capital with interest; and
- revenue authorities, who are concerned about abuse by excessive interest deductions.

An entity (which may be part of a group) may be said to be thinly capitalized when it has excessive debt in relation to its arm's length borrowing capacity, leading to the possibility of excessive interest deductions. An important parallel consideration is whether the rate of interest is one which would have been obtained at arm's length rate while comparing from independent lender as a stand-alone entity.

In international transactions, the typical method of tax avoidance employed is the use of a thinly capitalized subsidiary that borrows from the parent or an off-shore vehicle, with the lender being in a low tax jurisdiction.



The main purpose of such an exercise is to shift profits from the country where profits are made to a tax haven. Many countries have introduced withholding taxes on interest payments made by the thinly capitalized company to counter this shifting of profits. Thin capitalization rules usually go beyond just the levels of debt and equity.

Thin Capitalization rules can apply in situations where :

- A security is issued, which would not have been issued without a special relationship between the parties (tax deductions for interest on loans from group entities are stopped where the borrower would not have been able to sustain the debit on its own).
- A loan is made because of a guarantee given to the lender by a party related to the borrower.

The expression 'thin capitalisation' is commonly used to describe a situation where the proportion of debt to equity exceeds certain limits. Thin capitalisation legislation is a tool used by tax authorities to prevent the apparent leakage of tax revenues as a consequence of the way in which a company is financed. Financing a resident company with debt is considerably more tax efficient than financing with equity. The difference in tax treatment is an incentive to provide capital to the company in the form of debt instead of equity. If there are no thin capitalisation rules, it is relatively easy for a non-resident to advance funds to a resident company in a way that is christened as debt, so that the ''interest payments'' are straightaway tax deductible. If controlling shareholders in particular are indifferent to the form in which their investment is structured are more likely to be guided by tax considerations when structuring the legal form of their investment.

The object of Thin Capitalisation Regulations is to prevent the use of excessive 'captive' or 'in-house' or 'friendly' loans which would be detrimental to the revenue of home country (where the borrower is resident), as the profits to this extent would effectively be shifted to the foreign lender, as the interest payments would be tax deductible in the home country.

Therefore many countries—through Thin Capitalisation Regulations—ensure that the deductions for interest on debt owed to connected parties, is allowable in the home country as a deduction in the hands of the borrower, only if within the permissible limits. While financial leverage has, on its own standing, its own value, this is definitely impaired when interest is not deductible either wholly or partially through these Thin Capitalisation Regulations.

Brief Comparative analysis of Thin Capitalisation Rules by different jurisdictions

A wide variety of methods are used to deal with thin capitalisation in various countries. These approaches range from complex legislation to no specific thin capitalisation legislation at all.

Within this range four general approaches may be distinguished :

(1) the fixed ratio approach
(2) the subjective approach
(3) application of rules concerning hidden profit distributions; and
(4) the 'no rules' approach.

The emphasis on the above factors or combinations of factors often varies from country to country. Measures taken by countries to limit excessive debt financing by shareholders are either based on specific legislation or administrative rules or based on evolving practice.

Under the 'fixed ratio' approach, if the debtor company's total debt exceeds a certain proportion of its equity capital, the interest on the loan or the interest on the excess of the loan over the approved proportion is automatically disallowed and/or treated as a dividend. The ratio may be used as a safe-haven rule. It can be seen that these countries which use the fixed ratio approach usually have specific thin capitalisation legislation.

The basis of the 'subjective' approach is to look at the terms and nature of the contribution and the circumstances in which the financing has been made and to decide, in the light of all facts and circumstances, whether the real nature of the contribution is debt or equity. Some countries using the subjective approach have specific legislation. Other countries use more general rules if these are available, such as general anti-avoidance legislation, provisions on 'abuse of law', provisions on substance over form.

There are also countries that apply 'hidden profit distribution' rules to reclassify interest as dividends. In some of these countries the hidden profit distribution rules are applied along with specific rules which limit the deduction of interest on loans from shareholders. The general principles of transfer pricing rules may also play a role in this respect.The underlying idea is that if the loan exceeds what would have been lent in an arm's-length situation, the lender must be considered to have an interest in the profitability of the enterprise and the loan, or any amount in excess of the arm's-length amount, must be seen as being designed to procure share in the profits.

While some countries, like France, have detailed regulations, others, like the UK, do not specify a debt to equity ratio, but merely give the right to the Inland Revenue to challenge the interest deductions keeping in view the arm's-length principle.

In the following paragraph, a brief overview of the approach to Thin Capitailsation Rules in countries which provide for safe harbor provisions are given :

Country	Limitation	Comments
Australia	Debt : Equity 3 : 1	In 2002, Australia's thin capitalisation regime changed substantially, bringing in lengthy and complex legislation. A 'safe harbour' debt amount has been introduced, with an alternative ''arm's length'' test which can potentially increase the permissible interest Exceptions made for certain financial businesses—authorised deposit takers Interest in excess of the prescribed level is denied as a deduction. However, it is fully deductible if the company satisfies the arm's length test. The Australian Tax Office has a well-organised and accessible website, with good search facilities.

(contd.)

(contd.)

Country	Limitation	Comments
Germany	Limit to deductibility of interest (30% of income)	The legislation was substantially revised in 2008 Interest deductibility is limited to 30% of taxable income before interest, taxes on income, depreciation and amortisation. There are exceptions for low interest expense, and where interest paid to any one shareholder falls within limits. Previously Germany had a widely available safe harbour: a debt:equity ratio of 1.5 : 1
France	Interest limitation by ref to third party rates Arm's length measure for interest rate Debt : equity 1.5 :1 25% interest : operating income ratio	A new system was applied from January 2007, applying limitations between related parties, and bringing in the arm's length measure. Interest rate limitations : deduction limited to an average of rates charged by lending institutions, or the interest rate that the debtor company could have obtained from a third-party lender and Debt-based limitations : overall indebtedness (debt : equity ratio), and Disallowed interest can be carried forward indefinitely at group level, but will be reduced annually by 5% from the second year after the expense was incurred. There is no differentiation between types of companies. Companies are considered on a stand alone basis. Certain financial businesses and transactions are excluded.
Japan	3 : 1	• Japanese thin capitalisation rules were revised in 2006. • A debt:equity safe harbour rule applies to foreign-owned corporations • The 2006 rules extend this to third parties where foreign corporations guarantee the borrowing
China	Financial 5 : 1 Non-Financial 2 : 1	China introduced thin capitalisation legislation for the first time late in 2008. Two safe harbour ratios have been set, one for financial industry enterprises, one for non-financial. If these ratios are breached, it appears that the taxpayer will still have the opportunity to try to demonstrate that the transaction is still consistent with the arm's length principle.

(contd.)

(contd.)

Country	Limitation	Comments
USA	1.5 : 1	The US "earnings stripping rules" currently include a restriction on interest paid by a corporation to related persons, if the corporation has : A debt-to-equity ratio exceeding 1.5 : 1, and A net interest expense exceeding 50% of the company's adjusted taxable income. This is likely to be tightened, probably to 25%

India and Thin Capitalisation

As of now India does not have any specific Thin Capitalisation Rules. In one of the leading case on the subject, in absence of "thin capitalization rules", interest paid to shareholders for loans cannot be disallowed despite capital-structure tax-planning resorted by the tax payer. This was the decision by the Income Tax Appellate Tribunal (ITAT) in the case of Besix kher Dabhol SA v DDIT.

The assessee, a Belgium company, was set up to execute a project in India and had a PE in India. The assessee's share capital of Rs. 38 lakhs was owned by two foreign companies (shareholders) in the ratio of 60 : 40. The said two shareholders also advanced loans to the assessee aggregating Rs. 94.10 crores in the same ratio in which they held shares in the assessee i.e. 60 : 40. The assessee's debt-equity ratio was 248 : 1. The assessee paid interest of Rs. 5.73 crores on the loans obtained from its shareholders and claimed that as a deduction. The AO disallowed the claim on the ground that though the moneys were borrowed from the shareholders, in view of the abnormal debt-equity ratio, they were to be treated as capital / loan taken from the Head Office, and (ii) that as the RBI approval did not permit the PE to borrow, the loan was in contravention of law. This was upheld by the CIT (A). On appeal by the assessee, HELD allowed the appeal :

(i) Under Article 7 (1) & 7(3)(b) of the India-Belgium DTAA, the profits of the assessee as are attributable to the PE are chargeable to tax in India. In determining such profits, all expenses are allowable subject to limitations specified in the DTAA and the Indian laws. The only limitation is that notional interest paid by a branch to its HO is not allowable.This limitation does not apply as the assessee borrowed from an outside party, i.e. its shareholders;

(ii) The argument of the revenue that the abnormal debt-equity ratio attracts the "Thin Capitalization Rule" and that the "debt" should be characterized as "equity" for purposes of considering whether interest is deductible is not acceptable. Several countries have detailed "thin capitalization rules" (e.g. Belgium). However, there are no such rules in India though the

DTC 2010 has proposed this vide S. 123(1)(f). In the absence of specific ''thin capitalization'' rules, it is not open to the revenue to characterize debt as equity and disallow the interest (principles in Azadi Bachao Andolan 263 ITR 706 (SC) followed). The domestic law limitation of Art. 7(3) refers to the Source Country & not the Residence Country;

(iii) Imposing the ''thin capitalization rules'' on the assessee when domestic companies are not subject to such rules will violate the ''non-discrimination'' provision in Art. 24(5);

(iv) The argument that the finance structure should be treated as a ''colourable device'' and disregarded is not acceptable because there is no anti-abuse provision in the DTAA and in the absence of specific language (such as the proposed s. 129(9) of DTC 2010), the DTAA cannot be over-ridden by the Act.

Master Circular issued by RBI under Foreign Exchange Management Act, 1999 (FEMA) and Regulations

It would be of interest to note that the latest RBI Master Circular on External Commercial Borrowings (ECB) stipulates a debt equity ratio of 4 : 1 for borrowings by Indian Entity from ''Recognized Lenders'' in excess of US $ 5 Million from ''Foreign Equity Holders''. The Foreign Equity Holders should hold a minimum of 25% of the Equity of the eligible borrower. Further the regulations clarify ''ie. borrowing the proposed ECB not exceeding four times the direct foreign equity holding''. This adds a new dimension to the basic question of Debt Equity ratio.

General Anti-Avoidance Provisions (GAAR)

Though the Union Budget 2012-13 proposals do not contain any direct ''Thin Capitalisation Rules'', certain new provisions entitled ''General Anti-Avoidance Rules'' have been proposed, which, if implemented, can give rise to new dimensions to the issue of Thin Capitalisation concept.

The scope and language of the proposed GAAR provisions under the Union Budget 2012 are very similar to the GAAR provisions specified in the Direct Tax Code (DTC). It is proposed to empower the tax authorities with widespread powers to disregard and recast any tax avoiding transaction and income accruing therefrom. Further, the Finance Bill 2012 proposes the introduction of sub-section 2A to Section 90 which would enable the provisions of GAAR (proposed to be introduced through Chapter X-A in the Income-tax Act, 1961) to override the provisions of the tax treaties signed by India. While the revenue authorities may be viewing GAAR as a means to checking tax leakages, one may be tempted to suspect the intention of the sweeping nature of the provision as it provides wide discretion to the tax authorities and provides potential for misuse.

GAAR vs. Treaty provisions

It has been proposed that the GAAR provisions would apply to a taxpayer irrespective of the fact that the treaty provisions are more beneficial. It may be noted that a unilateral enactment of a new domestic tax law which is contrary to an existing treaty, without an amendment in treaty could possibly be regarded as violation of international law and is generally known as 'treaty override'.

It may be relevant to note that according to rules of legislative interpretation, specific legislation overrides general legislation. Therefore, an argument may be taken that change of a domestic law generally, which could be the case with GAAR, may not affect the treaty. However, in the absence of an anti-avoidance provision under the treaty, the reaction of India's treaty partner countries needs to be observed.

Salient features/provisions of GAAR

The Indian tax law has always had specific anti-avoidance rules to target known arrangements of tax avoidance, whereas GAAR seeks to completely redefine this concept. GAAR as envisaged under the Finance Bill 2012 is a broad set of provisions which seek to tax an 'impermissible avoidance arrangement' (which may be a step, a part or whole of an arrangement and hereinafter referred to as 'Transaction') whose main purpose is to obtain a tax benefit by :

a. creating rights or obligation which wouldn't arise between persons dealing at arm's length, or
b. result in the misuse or abuse of the provisions of the Act in any way, or
c. lacks commercial substance either wholly or in part, or
d. entered or carried out in a manner which would not be employed for bona fide purposes

While the principal condition for invalidating a transaction might be triggered at the assessment stage itself, the burden to rebut the same shall rest with the tax payer. Further, once the 'tax benefit' test is satisfied, the arrangement also has to satisfy at least one out of four additional tests discussed above.

The tax authorities, upon satisfaction of aforesaid conditions, shall seek to :

a. disregard, combine or recharacterise any step, part or whole of a transaction;
b. treat the transaction as if it had not been entered into;
c. disregard any accommodating party or treating any accommodating party and any other party as one and the same person;
d. deeming connected persons in relation to each other as one;
e. reallocating, amongst the parties to the arrangement —
   - any accrual, or receipt, of a capital or revenue nature; or

- any expenditure, deduction, relief or rebate; or

f. relocating place of residence of a party or location of a transaction or situs of an asset to a place other than provided in the arrangement; and

g. considering or looking through an arrangement by disregarding any corporate structure.

For the above purposes, following re-characterization may be done —

- any equity into debt, or vice versa;
- any accrual, or receipt, of a capital or revenue nature; or
- any expenditure, deduction, relief or rebate.

Meaning of some of the terms used in GAAR

1. Accommodating Party

Accommodating party means a party to an arrangement whose main purpose for direct or indirect participation in an arrangement (in whole or in part) is to secure benefits whether directly or indirectly to a person to whom it may be connected or not.

2. ''An arrangement'' means

- any step in or a part or whole of
- any transaction, operation, scheme, agreement or understanding,
- whether enforceable or not, and
- includes any of the above involving the alienation of property.

3. ''Tax benefit'' means

- a reduction, avoidance or deferral of, or an increase in a refund of tax under the Income Tax Act (''ITA'' or ''the Act'').
- a reduction, avoidance or deferral of, or an increase in a refund of tax for a Tax Treaty.
- a reduction in tax bases including increase in loss.

4. ''Arm's length price'' means

- a price applied or proposed to be applied in a transaction between persons or enterprises other than associated enterprises in uncontrolled, unrelated or independent conditions.

5. ''Associated Enterprises'' means as defined in Section 92A of the Act.

6. ''Lacks commercial substance''

A step in, or a part or whole of, an arrangement shall be deemed to be lacking commercial substance, if —

- The substance or effect of the arrangement as a whole, is inconsistent with, or differs significantly from, the form of its individual steps or a part; or

- it includes, or involves —

i. round trip financing without regard to, —

(a) whether or not the round tripped amounts can be traced to funds transferred or received;

(b) the time, or sequence, in which round tripped amounts are transferred or received; or

(c) the means by, or manner in, which round tripped amounts are transferred or received;

ii. an accommodating or tax indifferent party;

iii. any elements that have the effect of offsetting each other; or

iv. a transaction which is conducted through one or more persons and disguises the nature, location, source, ownership, or control, of the fund.

7. ''Round trip financing'' includes financing in which —

Funds are transferred among the parties to the arrangement in a manner which would :

- result, directly or indirectly, in a tax benefit; or
- significantly reduce, offset or eliminate any business risk incurred by any party to the arrangement.

Some Concerns about GAAR and recommendations to overcome them

The description and definition as proposed renders GAAR subjective and open to interpretation. Perhaps, introduction of guiding principles should be evolved so as to make the same objective, more definite, fair, equitable, meaningful and relevant.

Specifically if one were to refer to the explanation / meaning of ''lacking of commercial substance'', this one phrase can typically lead to a series of litigations. With the shifting of the onus of proof to the taxpayer, it has to be only hoped that the final outcome of the interpretation does not result in 'Commercial Nonsense'

Though the provisions relating to GAAR are broadly in line with the internationally accepted standards of anti-avoidance measures, it may be noted that some of the important recommendations of the Standard Committee on Finance have not been taken into account while introducing the GAAR provisions, such as :

- Suitable provisions may be made to protect the interest of the tax-payers who have entered into structures / arrangements under the existing law in good faith and without intent to evade tax;

- Uncertainties with regard to applicability of tax treaty provisions to be removed so that India's credibility as a reliable treaty partner is not affected;

- The proposals should not lead to any fiscal uncertainty or ambiguity;

- It should be ensured that any of the proposals do not pave the way for increased and avoidable litigation.

With respect to thin capitalization, an entirely new concept of re-characterization of debt into equity or vice versa. The emphasis is on the term ''vice versa'' which means that debt can also be classified into equity. Such reclassification including the circumstances in which this could result will be a completely new concept to which this complex financial world may not have a ready answer.

Applicability of Thin Capitalisation Norms for domestic companies

The budget proposals have introduced a new section by which specified domestic transactions have been brought under the purview of Transfer Pricing regulations. The computation of value of Specified Domestic Transactions should, therefore, be as per Arm's Length provisions under Transfer Pricing regulations. The provision would be applicable if the value of Specified Domestic transactions in aggregate exceeds 5 Crores.

The Specific Domestic Transactions for the purposes of application of Transfer Pricing provisions would be :

(a) Expenses / payment transactions between related persons as covered under the provisions of Section 40 A (2) (b);

(b) Transfer of goods / services / business from one unit / undertaking of the Assessee to another unit / undertaking of the assessee, claiming benefit under Section 80 IA, under Chapter VI A or 10 AA where the provisions of 80IA are applicable;

The assessees in such cases would be required to maintain / furnish documentation and obtain certification of Specified Domestic Transactions.

The other Transfer Pricing provisions pertaining to international transactions would also be applicable for Specified Domestic Transactions.

Section 40A (2)(b) would even cover transactions of interest payments to related parties and consequently the provisions contained in the other transfer pricing regulations including the GAAR and the thin capitalization rules / test could apply to quasi-equity financing by related parties christened as debt. This is going to be a new challenge for domestic companies, most of whom are not even exposed to the concept of Thin Capitalisation and the prevalent rules.

Challenge before Indian Companies

Indian companies having international transactions are exposed to international financing pattern and the global taxation trends. For these companies, the concept of thin capitalization is going to add a new variable to the financial and tax structuring.

The greater challenge is, however, going to be faced by pure domestic companies in the SME sector, where there is a reasonable amount of related party transactions much beyond the stipulated the threshold levels of Rs. 5 crores which appears to be fairly low.

When there are many SME companies / organizations in a group, a great deal of planning would have to be done to plan and implement the capital structure in such a way that the group goals are achieved without falling into the erring side of the tax net.

Quite a few companies in the SME sector are known to be facing finance problems and are struggling to obtain debt financing at competitive rates. In such cases, it is usual for the companies to arrange finance from related parties (including group companies) in the form of unsecured loans carrying structured interest rates rather than equity to meet the promoter's contribution requirements for obtaining maximum possible bank finance. The lending banks treat this ''structured debt'' as ''Quasi-Equity'' and fit it as ''Equity'' in their assessment for ''Debt-Equity Ratio''. If this structure is viewed by the tax authorities under the lens of GAAR and read with the proposed domestic transfer pricing regulations and the interest charged is below the bank rate, the tax authorities can, under this situation, impose tax on the differential interest or even treat this ''structured debt'' as equity, and disallow the interest deduction claimed by the borrowing company. All these could lead to uncertainties and unpredictable litigations.

There will be widespread ambiguity on what is the ideal or safe debt-equity ratio which would be acceptable to the tax authorities. We have seen the confusion created by the RBI Master circular while stipulating the debt-equity ratio with respect to ECB from foreign equity holders. When we have multiple regulators giving different interpretations and meanings to otherwise established definitions, the problem becomes more complex. Further complicating this would be the GAAR driven as it would be by revenue collecting considerations, the emerging confusion is going to be more and more difficult to comprehend—particularly to the domestic SME sector which is in dire need of greater flexibility and openness.

There will be a great role for Management Accountants and other financial consultants in evolving a proper group structure and also capital structure for individual entities, apprising them of the regulations and consequences of default simultaneously so that there emerges

(a) good commercial sense not only at the group level, but also at the entity level; and

(b) there is better understanding on the part of these groups and entities of the complex level of challenges to be faced in balancing commercial, regulatory and tax considerations; and

(c) the potential for commercial nonsense—which disastrous short term opportunistic planning will anyway entail—is reduced. ❐

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Arm's Length Pricing in India

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Introduction

The Arm's Length Principle is the condition that both the parties to a transaction are independent and are on equal footing. This type of transaction is known as an 'Arm's Length Transaction'. It is generally use in contract law for the arrangement of an equitable agreement though either the parties may have shared interests or they are closely related to each other to be seen as completely independent. In the present global business environment it is observed that large multinational companies have subsidiary companies and those companies conduct business transactions with one another as if they are not at all part of the same corporate family. When two companies, any way, are connected with each other, the type of business they transact is often referred to as an 'arm's length transaction'. It is a deal between two interested associates parties. They show the behaviour as if they were not related, so that there is no query of a disagreement of attention. The concept of arm's length deal concerns with the transaction in which both the parties behave in their self-attention and are not issue any force from the other associate. The basic principle behind the arm's length price is that though the both the buyer and seller are related to a parent concern, the prices extended will still remain at fair market value. This means that the seller company will offer no special in-house discount to the buyer company though both of them are subsidiaries of a parent company i.e. the subsidiary company will enjoy the same volume of discount that may be extended to any customer with a similar pattern of volume purchasing. So, the arm's length price is the price in which a sister company never expects any discount or reduced price that would be extended to other customers. The comparability between the controlled and uncontrolled transaction is the key factor for determining the arm's length price an international transaction.

Arm's length price essentially conducts two things at a time : (i) this form of pricing structure protects the financial position of the seller company; and (ii) helps to prevent the question of taxes arising from such transaction. Many countries including India have their laws for determining inter-company or arm's length price structures. With the extension of arm's length price, there is no question about conflict of interest of buyer and seller. Here the revenue is completely transparent and there is no hidden motive in the transaction. According to the internationally accepted principles, any income from international transaction or an outgoing—like expenses or interest from the international transaction between associated companies—shall be computed extending an arm's-length price that would be charged in the transaction if it had been entered into by unrelated parties in similar conditions. Some companies occasionally try to manipulate inter-company prices to reduce overall tax burden. On the other hand, tax authorities want to ensure that the inter-company price is equivalent to an arm's length price to prevent the loss of tax revenue.

Computation of Arm's length Price u/s 92C of Income Tax Act

The arm's length price in relation to an international transaction shall be determined by any of the following methods, being the most appropriate method :

(a) Comparable Uncontrolled Price Method,
(b) Resale Price Method,
(c) Cost Plus Method,
(d) Profit Split Method,
(e) Transactional Net Margin Method, and
(f) Such other Method as may be prescribed by the Board.

From the above six methods the most appropriate method shall be applied for determination of arm's length price provided that, where more than one price is determined as the most appropriate method, the arm's-length price shall be taken to be the arithmetic mean of such prices or at the option of the assessee, a price which may vary form such arithmetic mean not exceeding five per cent. To make it clear we may compute arm's length price only under Comparable Uncontrolled Price Method taking an imaginary illustration.

Arm's Length Price under comparable Uncontrolled Price Method

1. First identify the price charged of paid for property transferred or services rendered in a comparable uncontrolled transaction.

2. Then adjust the price derived in first step above for differences, if any, which could affect the price in the open market.

Illustration : X Inc, a French company, and Y Ltd., an Indian company, are associated enterprises. Y Ltd. manufactures Mobile Phones and sells those to X Inc and Z, a company of Bangladesh. During the year, Y Ltd. supplied 2,00,000 Mobile Phones to X Inc @ Rs. 2,500 per unit and 50,000 units to Z @ of Rs. 5,000 per unit. The transactions of Y Ltd. with X Inc and Z are comparable subject to the following considerations —(a) The freight and insurance paid by X Inc per unit is Rs.500, (b) Sales to Z are under a free warranty for one year whereas sales to X Inc are without any such warranty. The estimated cost of warranty is Rs. 200. (c) Since X Inc's order was huge in volume, quantity discount offered Rs. 200 per unit.

Computation of Arm's Length Price of product sold to X Inc, a French company by Y Ltd.

Particulars	Rs.	Rs.
Price per unit in a Comparable Uncontrolled Transaction		5,000
Less: Adjustment for Differences :		
a) Freight and Insurance Charges	500	
b) Estimated Warranty Costs	200	
c) Discount for Voluminous Purchase	200	
		900
Arm's Length Price for Mobile Phone sold to X Inc.		4,100

Computation of Increase of Total Income of Y Ltd.

Particulars	Rs.
Arm's length Price per unit	4,100
Less : Price at which actually sold to X Inc.	2,500
Increase in Price per unit	1,600
No. of Units sold to X Inc. 2,00,000 Therefore, increasing in Total Income of Y Ltd. (Rs.1,600 × 200,000)	32,00,00,000

It is observed in the above illustration that though Y Ltd sold to X Inc. and associated enterprise at lower price but arm's length price would be Rs. 4,100 per unit and Y Ltd's total income would be increased by Rs.32 crore and tax on the increased amount would be paid at appropriate rate in India which, in turn, controlled the erosion at tax revenue in India.

Guidance of Applying Arm's Length Principle

The arm's length principle is the internationally accepted standards are adopted by many member countries of the 'Organization for Economic Cooperation and Development' (OCED) as well as non-member countries. The arm's length principle is adopted by most of the tax jurisdictions. To comply with this internationally accepted principle, the tax authority as well as tax paper will find a common basis of deal with related party transactions. This obviously reduces the incidence of transfer pricing adjustments and also will improve the resolution of transfer pricing disputes. As a result of which double taxation will be reduced.

The application of arm's length principle involves the identification of comparable situations or transactions undertaken by the independent parties against which the related party transaction is to be benchmarked. This is commonly known as 'Comparability Analysis'. It analyses the similarities and differences in the conditions and characteristics in the related party transactions with those of an independent party transaction. For such price or margin comparisons are meaningful. All economically relevant characteristics of the situations should be compared and successfully similar to that :

(i) differences (if any) between the situations being compared can't materially affect the price or margin being compared, or

(ii) adjustment can be made to eliminate the effect of any such differences.

The ultimate objective of comparability analysis is a comprehensive assessment and identification of the areas and the extent of significant similarities and differences between the transactions and those to be benchmarked against.

Legal Provisions in India with regard to Arm's Length Price

Computation of income from international transaction in India in relation to arm's length price is governed by Income Tax Act, 1961, under Section 92. The Finance Act, 2001, introduced the Transfer Price Regulation (TPR) in the Income Tax Act, 1961, by enacting New Section 92 to 92F in the Income-tax Act, 1961, in substitution of the earlier Section 92. Therefore, TPR are effective from the Assessment year 2002-2003 and obviously would be applicable to international transaction w.e.f. 1st April 2001. The new provisions will be applied for 'Associated Enterprises'. As per new provisions, where an Assessing Officer is in the opinion that the transaction between Associated Enterprises are not at arm's length, he can compute profits from such transactions at arm's length price. Under Section 92 any income from international transaction shall be computed having regard to the arm's length price.

Meaning of International Transaction described u/s 92B along with Sections 92, 92C, 92D and 92E where 'international transaction' means a transaction between two or more associated enterprises either or both of whom are non-residents, in the nature of purchase, sale or lease of tangible or intangible properties ... with a benefit, service or facility provided or to be provided to any one or more of such enterprises. Maintenance and keeping of information and document by persons entering into international transaction is governed by Section 92D. According to this section 'every person who has entered into an international transaction shall keep and maintain such information and document in respect thereof, as may be prescribed ... The Assessing Officer or the Commissioner (Appeals) may, in the course of any proceedings under this Act, require any person who has entered into an international transaction to furnish any information or document in respect thereof, as may be prescribed under sub-section (1) within a period of thirty days form the date of receipt of a notice issued in this regard. 'The accountant should furnish a report on international transaction during the previous year on or before the specified date in the prescribed from duly verified and signed by such accountant u/s 92E.

Section 92F gives definition of certain terms ''accountant'', ''arm's length price'', ''enterprise'', ''specified date'' and ''transaction''. According to this section "arms length price" means a price which is applied or proposed to be applied in a transaction between persons other that associated enterprises, in uncontrolled conditions.

Penalty in International Transaction

Penalty for failure to keep a maintain information and document in respect of international transaction may be imposed vide Section 271AA. Under this section ''If a person fails to keep and maintain any such information and document as required by sub-section (1) or sub-section (2) of Section 92, the person shall pay, by way of penalty, a sum equal to two per cent of the value of each international transaction entered into by such person''. Under Section 271BA 'If any person fails to furnish a report form an accountant as required by section 92E, the Assessing Officer may direct that such person shall pay, by way of penalty, a sum of on hundred thousand rupees'. Section 271 G provides 'If any person who has entered into an international transaction fails to furnish any such information or document as required by sub-section (3) of Section 92 D, the Assessing Officer or the Commissioner (Appeals) may direct that such person shall pay, by way of penalty, a sum equal to 2 per cent of the value of the international transaction of each such failure'.

The Government has kept sufficient legal penalty measures against wrong computation of income from international transaction having regard to arm's length price.

Role of CMAs in Arm's Length Pricing

In the present scenario of world economy the Accounting Profession is one of the most important challenging professions. The role of Cost and Management Accountants (CMAs) has become more important in corporate level, national level and also international level. With expertise knowledge in costing, finance, taxation and management the CMAs perform a service of works to ensure the company's or employ's financial security, handling financial matters and, accordingly, helping to drive the overall management and strategy of the concerned business. A CMA's responsibilities include planning costing system and methods, project management, internal audit, cost audit, fund management, pricing planning, designing and implementing effective management information and control system. On the basis of those he may guide the top management providing necessary information to take right decision in right time.

In our discussion so far we have observed that arm's length pricing is a complicated one and breaking the law and rules exist in India regarding arm's length price imposes high penalty. We know that there has been increasing awareness among the business entrepreneurs that the CMAs have vital contribution in the business houses to the attainment of business objectives. With expertise knowledge of tax and accounting along with other branches of management the CMAs obviously may help the associated enterprises in relation to international transactions associated with arm's length price. The CMAs may compute the arm's length price using appropriate method and save the company from bearing the penalty which may be imposed by the Assessing Officer or Commissioner (Appeals). On the other hand computing profit from international transactions at arm's length price arrange for paying right amount of income tax to the Government. Now-a-days CMAs cooperate with the companies by leading from the front —not sitting as backbench advisors. ❐

Tax Titbits—Finance Bill, 2012— What Next?

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Direct Taxes Code Bill, 2010 (the Code), which was to take effect from 1st April 2012, is now officially postponed for application from 1st April 2013. Meanwhile many of the drastic provisions have found their way in the proposals in the Finance Bill, 2012. There is considerable uncertainty as to the incidence of tax on trade and industry consequent on these proposals, which have been prompted without any prior consultation with the profession or trade and industry.

The only hope of the taxpayer is a report received from the all-party Standing Committee of Parliament on Finance on the Code presided by a former Finance Minister, which has undertaken an elaborate exercise of discussing provisions in the Code with all the stake-holders and the reaction of the tax administration and had come out with recommen-dations without any dissent. The report has been made available just before the Finance Bill was presented before the Parliament without the Finance Minister having time to consider these recommendations in respect of those proposals in the Finance Bill, which have been lifted from the Code.

The suggestion generally made in the light of the provisions of the Code are applicable even for the new proposals in the Finance Bill, 2012, especially in matters of amendments relating to international taxation with over-anxiety on the part of revenue to nullify every argument for liability found untenable in the decision of the Supreme Court of Vodafone International Holdings B.V. v. Union of India (2012) 341 ITR 1 (SC) and a number of other decisions of the Courts.

It is now not too late to consider the Committee Report on the Code in many of the proposal in the Finance Bill based on the Code before it becomes law or even after, so that the confidence of the investors both domestic and foreign on the future of the economy is not lost and their after-tax return on investments can be ascertained with certainty. The favourable climate in recent years should not be endangered by some of the hasty amendments, which are made worse by making them retrospective.

The Spectre of GAAR

Elaborate provisions under new Chapter X-A read with Section 144BA known as General Anti-Avoidance Rule (GAAR) propose to empower the Assessing Officer to ignore ''imper-missible avoidance arrangement''. He could ignore the corporate form of the parties to an arrangement, adopt accrual of income at a different place or at a different time. He could infer a residential status different from its place of incorporation or the tax residency certificate from the parties to the Double Tax Avoidance Agreement. These and other inferences could be drawn not all based upon evidence, but on the sole ground, that tax is saved. Tax mitigation or saving based on tax costing is treated by these provisions as tax avoidance on par with tax evasion.

GAAR can be invoked at the instance of the Assessing Officer with the approval of the Commi-ssioner after consultation with an Approving Body consisting of three more Commissioners, so that it is a decision of the tax administration. The Standing Committee had recommended that it should have independent members with technical qualifications. The provisions place the burden of proof on the taxpayer to show that the transaction is not covered by the anti-avoidance arrangement. The Standing Committee requires that the onus should be squarely placed on the authorities.

The Finance Bill, 2012 and the Code Bill would require the domestic law to override the commitments under the Double Tax Avoidance Agreement. The Committee says that it will affect India's credibility as a reliable treaty partner. These three aspects of the provisions relating to anti-avoidance agreement are required to be reconsidered by the Finance Minister in the light of a Committee report consisting of members from all parties including ruling party and its allies, so that there can be no justification whatsoever for carrying the proposals in the Finance Bill without considering the recommen-dations of the Committee on the Code on the same matters arrived at after elaborate consultations.

Deeming provisions galore

The Finance Bill, 2012, provides for a number of deeming provisions which do not have the character of income, but the amendments would still consider it as income. There may be justification for some of the deeming provisions in present provisions, but the proposed provisions are violative of accepted principles of law and are not in response to any felt need, but had been hastily incorporated without considering either the justification therefor or their possible impact.

One of the deeming provisions is to treat the proceeds of sale of software as royalty contrary to the accepted provision of law in indirect tax cases, that these are goods liable for sales-tax or import duty. It has been recognized as merely sale of copyrighted product and not assignment of copy-right in a number of decisions of the Courts even for income-tax purposes. The proposed amendment to Section 9(1)(vi) would make a nullity of this law affecting a business in which India has a lead in the world market.

The proposal for taxing the income from satellite communication to nullify the decision of the Courts is another deeming provision.

Deeming of share premium of companies in which public are not substantially interested being public sector and listed companies with reference to fair market value of the shares is yet another deeming provision, which will create problems of valuation apart from absolute lack of logic in taxing the company on an income on the value addition to the shares, when the shareholders will be allowed only the amount paid for by them in the event of their sale of their shares.

Yet another deeming provision will treat any restructuring exercise among the group concerns even without any cash implications neutralising the precedents of the courts and the rulings of the Authority for Advance Ruling in more than one case.

Proposal for adoption of arm's length price

In the light of the track record of precedents on application of arm's length rule for international transactions in both choice of the rule for valuation and comparables, its extension to domestic transac-tions with related parties is ill-considered. It will take a heavy toll on the taxpayer in compliance with equally heavy burden on the department in administering it.

Audit requirements

There has been an upward revision of the limits for compulsory maintenance of business and profession under Section 44AA as well as tax audit requirement under Section 44AB, besides making the presumptive taxation applicable for all busi-nesses under section 44AD with a limit now raised to Rs. 1 crore. While these are generally welcome, an excellent opportunity is being missed for making audit more useful for ascertaining the correct income.

The new requirements under company law for costing records and cost audit in some cases for manufacturing industry have not been taken note of nor are the Cost Accounting Standards issued by the Institute of Cost and Management Accountants of India. Even the suggestion for certification of stock by the Cost Accountant has been diluted by the Standing Committee by limiting it to cases where check is required by the authorities by way of special audit and not to make it obligatory by an omnibus clause. But even this limited recognition in the Code does not find a place in the Finance Bill. Sections 44AA and 44AB will be more effective if the expertise available from the costing profession is harnessed for income-tax purposes.

Conclusion

Many of the proposals in the Finance Bill are required to be reviewed or deferred in the light of the Standing Committee Report, since the Parliament cannot speak in two voices—one through Standing Committee Report and the other through the Finance Bill. ❐

Coming Home to Roost : Bilateral Investment Agreements : Coping With Treaty Boomerangs

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It is a fact of Modern Economic Life, since the advent of Globalization and Liberalization from 1990s especially, that most countries—Developed or Developing—Socialist or Market-Oriented—have been wooing investments from all over the world. Thus there are Capital Exporting Countries and Capital Importing Countries. The flow of investment is generally carried through and by Private Enterprises, even though investments by Government entities are not unknown. It is natural for the investors to worry about the safety of their investments and the certainty of the repatriation of returns from such investments to their hands. The economic history of the world is replete with instances of destruction of investments and even imprisonment of the investors by dictatorial regimes. The wave of nationalization of economic resources following extensive decolonization in the 1950s and 60s put paid to the fortunes of many a western investor. Thus, given the historical baggage and the institutional instability behind many government policies it is natural for the investors to want to be assured of the safety and certainty of their investments flows. Since investors at their individual level cannot force governments on their own, it has fallen to the lot of governments everywhere to consider negotiating suitable terms with other countries regarding investment promotion and protection. With even nations competing in the market place of the world in the new age of Globalization, it has become essential to continue to attract and retain investments. As a corollary of this paradigm, governments were forced to offer terms of protection to investments. Thus many Bilateral Investment Promotion and Protection Agreements (BIPAs for short) were born. Today, there are said to be around 3,000 such Agreements among about 120 countries of the world. India alone has Agreements with nearly 82 Countries. It is a telling admission of the state of affairs in the investment jungle that despite such a massive number of bilateral agreements, countries have shied away from agreeing on a multi-lateral framework on investment promotion and protection. The BIPAs have become entrenched as a significant core of the International Investment Law coupled with the International Convention on the Settlement of Investment Disputes (ICSID), United Nations Convention on International Trade Law (UNCITRAL), the World Bank Guidelines On The Treatment of Foreign Direct Investment (1992) and the WTO-inspired Trade Related Investment Measures (TRIMs).

Many commentators have expressed surprise that Vodafone could actually serve (as reported in the press) a notice of dispute with the Government of India, under the Indo-Dutch Bilateral Investment Promotion & Protection Agreement (BIPA, for short) regarding the tax liability case arising from their investment in India. It is not clear if it is a notice for negotiation or conciliation or arbitration. The commentators have said variously that Vodafone lacks privity with the Government of India and that such treaties are between Nations which are not accessible to private companies. Vodafone tasted success in their case against the Income Tax department in the Supreme Court and the GOI has sought to undo the effect of the judgement by bringing in a retrospective amendment in the tax law to validate the tax demands and forestall such judgments. The power of the Parliament to impose a tax with retrospective effect may not be entirely unencumbered in a legal system based on the concepts of Rule of law, Due process and Protection against Unreasonableness. It is doubtful if a change in the law could annul a delivered and conclusive judgement of the highest court in the land without an express provision in the law for negating exactly such a judgement and whether such a provision would in this day and age be accepted by the Apex court without being seen as an interference with the Decisional Independence and Integrity of the Apex Judiciary as distinct from its institutional independence which alone is guaranteed by rights of tenure and removal only by impeachment etc. The changed law would of course apply to pending lis, even an appeal, but it may not be able to overturn and re-open the judgement of the top court already given to a party. The Apex court have held in some cases that they would not be averse to holding down a retrospective taxation if it was excessive or unreasonable. Interference with the decisional independence of the Apex judiciary does not, so far, appear to have been mooted as a possible ground of invalidating a retrospective taxation. The purpose of this article is not to enter into this debate but discuss the broad features of the BIPAs that investors would claim under.

The Government of India has the executive power to reach Treaties, Accords and Agreements with other Nations and Inter-Governmental Organizations. A curious category of such an area in the realm of Foreign Relations is the agreements to promote and protect investments of foreign investors in India. Such agreements are required by influential governments on behalf of their investing nationals and companies. India has entered into many such treaties with many nations. The agreements would have variations from BIPA to BIPA, though broad principles of protection will be common. Such agreements are inter-governmental accords but they provide for investors of one nation investing in the other nation to claim protection and compensation under the BIPA. Thus BIPAs grant privity to an individual as well as a company. For example, the India-UK BIPA defines vide Article 1(b) that the ''investment'' protected includes ''asset of every kind ... established or acquired...including changes in the form of such investment''. Article 3(2) assures the investors ''fair and equitable'' treatment of their investments and that the investments ''shall enjoy full protection and security''. MFN status and National treatment are also guaranteed in the BIPA. Article 6 dealing with compensation for losses allows restitution or adequate compensation, inter alia, to investments subjected to requisitioning or ''destruction by ''authorities and forces'' of the state in which such investments were made when such action was not caused by combat or by the ''necessity of the situation''. Article 9 of this BIPA allows an investor to settle their disputes with the government by negotiation or failing which by International Conciliation under the procedures of UNCITRAL and further failing which the investors can ask for International arbitration. If no agreement for referral to arbitration is feasible, either state party can request the President of the International Court of Justice for the needful steps to bring about arbitration in this regard.

Despite the significant number of the BIPAs signed by India, the treaties are not known to have been judicially tested. The Dhabol power project case ended in settlement rather than in arbitration from inter-state intervention.

In this Article, I propose to examine the important features of Bilateral Investment Treaties (BITs) in the light of the VODAFONE Tax imbroglio, the cancellation of 2G licenses of certain Foreign Corporations in India and the action of the foreign companies in invoking treaty protection.

Bilsyrtsl Investment Treaties

These are Inter-Governmental Agreements between Capital Exporting and Importing States with a view to promote and protect the investments of National Investors investing in the State of the party to the Investment Agreement. These Treaties have a number of features demarcating the rights of investors and the obligations of the host-states in relation to the investors. Even though countries managed to add variations from BIPA to BIPA, there are many common principles found in such Agreements which are described as follows:

- The Scope of Application by defining Investors and Investments promoted and protected.
- Admission of investments.
- Standards of Treatment post-entry including Investment Protection.
- Protection against Expropriation and Destruction of Investments.
- Assurance of Fair and Equitable Treatment.
- Dispute Settlement Process in the event of a dispute between a Foreign Investor and the Host State.

Thus, it can be seen that these Treaties focus essentially upon the rights of the Investor and the Obligations of the Host State, rather than on the

Obligations of the Capital Exporting State or indeed the Obligations of the Investor himself. Now let us examine each of the above features :

1. Scope and Application : The Investment Agreements are normally Bilateral or Regional in nature and there has been no Multi-Lateral Convention in place. The Investors covered include Natural Persons as well as Legal Entities, generally. Many Modern Agreements rely on Domestic Law to define Natural Persons. When it comes to Legal Persons, the Treaties seem to use a combination of principles such as Commercial Domicile, Nationality and the Seat and Control of such Entities by Nationals of the Party etc. In the light of the increasing using of subsidiaries and foreign companies to manage and control investments in Third States or even in the Home State of the original investor, the use of BITs as a legitimate tool in Investment Protection has become controversial. Treaty Shopping and abuse of readily available rights are not uncommon. In the case of Tokio Tokeles Vs Ukraine, the International Arbitral Tribunal held by majority that a Company owned by Ukrainian Investors, but located in Poland, would use the BITs between the two States to claim Investment Protection for its investments in Ukraine. Only the Chairman of the Tribunal dissented from the majority verdict.

2. Investment Profection—Thesalini Test : As regards the Nature of Investments to be protected, many BITs feature liberal definitions considering an investment to be an asset having an economic value. The Treaties are seen to cover investments established or acquired in the Host Country. However, many Arbitral Tribunals have concluded that four conditions would be essential in this regard. The Salini Test, [named after the Award given on 23rd July 2001 in the case of Salini Construtorri S.p.A. and ItalsTrade S.p.A. Vs Morocco (Jurisdiction of ICSID case No.ARB/00/4-Italy / Morocco BIT)] lists the following in this regard :

- A Contribution of Money or other assets of economic value.
- A certain desirable duration.
- An element of risk-taking in such investing.
- Contribution to the Host State's Development.

However, such a restrictive, normative definition is not widely shared and remains controversial, though apparently desirable. The Salini Test will be in the service of India's interests.

3. Admission or Est Ablishment of Investment : The Treaties have followed different approaches to Norms of Admission of Investment for Promotion and Protection. The majority approach encourages a liberal admission policy bestowing Most Favoured Nation status (MFN) and National Treatment. Market access is also assured in certain Treaties.

4. Treatment and Profection : The main principles in this regard are Most Favoured Nation Treatment, National Treatment with some restrictions. The Norms include fair and equitable treatment and protection against expropriation as well as security. The Treaties also guarantee repatriation of investment proceeds and foreign exchange availability for the same.

5. Expropriation : Expropriation refers to deprivation by the State of foreign rights to property or its enjoyment (Principles of Public International Law—Brownie). This can take several different forms and the process consists of both direct and indirect expropriation. The Direct Expropriation can take the form of confiscation, requisition or Nationalization, all with or without compensation or even with inadequate compensation. On the other hand, Indirect Expropriation can take several forms and is said to occur when a State subjects foreign property to taxation, regulation or other action that is confiscatory or that prevents, or unreasonably interferes with, or unduly delays the effective enjoyment of a foreign person's property or its removal from the State territory. Investment law jurists have classified potential categories of Indirect Expropriation that would be resulting in international concern as follows:

- Forced sales of property.
- Forced sales of shares.
- Indigenization requirements.
- State's management control over the investment.
- Inducing others to physically take over the property.
- Failure to provide protection when there is interference to the property of the foreign investor.
- Administrative Decisions which cancel licenses and permits essential for the foreign business to function within the State. (foreign 2G license holders whose licenses were cancelled might be expected claim under this ratio)

- Exorbitant Taxation.
- Expulsion of the foreign investor contrary to International Law.
- Acts of harassment such as freezing of bank accounts, promoting of strikes, lock outs and engineering labour shortages.

The above classification of Indirect Expropriation is not exhaustive. Recently other forms of Government action that can reduce the value of an investment have also been discussed as tantamount to Expropriation and often described as 'Regulatory Takings'. In International Law, a differentiation is made between Lawful and Unlawful Expropriation. Lawful Expropriation involves an obligation to pay compensation, while Unlawful Expropriation engenders an obligation to pay damages for the violation of legal obligations. There is always a state of tension between Sovereign Rights to regulate in public interest relating to any investment issue and the International Obligations flowing from such Bilateral Treaties.

6. Assurance of Fair and Equivatable Treatment : Many treaty arbitrations have centered on the guarantee of ''fair and equitable'' treatment to the investments of the investors. Internationally, the fair and equitable treatment principle presupposes the satisfaction of the following components:

A. Respect for the legitimate expectations of the Investors.

B. Duty of the Host State to act in a consistent manner ... free from ambiguity and totally transparently.

7. The Dispute Settlement : The BIPAS call for ''disputes'' between the investor and the Host state to be settled through negotiation first and then by International Conciliation. If all the recourses fail, then either party to the dispute can call for International arbitration. The mechanism is under the auspices of International Convention for Settlement of Investment Disputes (ICSID).

The ICSID Tribunal in the case of AZURIX V ARGENTINA while interpreting the scope of full protection of the investments under such treaties has laid down that the ambit goes far beyond mere physical protection of the investments and calls for the Host state to assure the stability afforded by a secure investment environment. The Indian retrospective amendment in the tax law may have to face stiff challenge under the BIPA if International trends are any indication.

So far, India has not had any arbitral threat in relation to the BIPAs it has entered into. The only danger was from la'ffaire Enron which was settled without incurring arbitration.

Conclusion

While protection of investment has become a prerequisite and an inevitable incentive to the promotion of International Investment needing a set of guarantees which should not be normally resiled from, Emerging Economies like India fear the consequential narrowing of their sovereign scope to regulate such investment activities or baleful consequences of such investing, e.g., in the Environ-mental Arena. Another case in point is the recent Supreme Court Judgment canceling some 122 2G Spectrum Licenses, some of which are held by foreign investors such as Norway Telecom and Sistema of Russia. The affected investors have reportedly invoked protection of their Bilateral BITs. India finds itself painted into a corner by its own Bilateral Treaties. It has so far avoided going for International Arbitration regarding disputes under the Bilateral Investment Treaties. The Bilateral Treaties bristle with complex provisions and subtle variations. The starkness of the obligations is also clear. Additionally, India will have to contend with the increasing rate of interpretations put out by Arbitral Tribunals, especially in the developing area of Indirect Expropriation and the scope regarding 'fair and equitable' treatment. There may be lessons to learn for India from the inevitable heavy bill that the country may have to pay for the Bilateral Treaties and the intractable VODAFONE and 2G license cancellation Tangles. The solution may lie in canvassing and promoting a Multi-Lateral Framework on Investment Promotion and Protection which plays fair by all the sides. ❐

Documents for Availing Cenvat Credit—Some Issues

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Rule 9(1) of CENVAT Credit Rules, 2004, provides that the CENVAT credit shall be taken by the manufacturer or the provider of output service or input service distributor, as the case may be, on the basis of any of the following documents :

(a) an invoice;
(b) a supplementary invoice;
(c) a bill of entry;
(d) a certificate issued by an appraiser of customs
(e) a challan evidencing payment of service tax, by the service recipient as the person liable to pay service tax;
(f) an invoice, a bill or challan issued by a provider of input service;
(g) an invoice, bill or challan issued by an input service distributor.

Invoice

Rule 9(1) (a) provides that an invoice may be issued by :

(i) a manufacturer for clearance of —

(I) inputs or capital goods from his factory or depot or from the premises of the consignment agent of the said manufacturer or from any other premises from where the goods are sold by or on behalf of the said manufacturer;

(II) Inputs or capital goods as such;

(ii) an importer;

(iii) an importer from his depot or from the premises of the consignment agent of the said importer if the said depot or the premises, as the case may be, is registered in terms of the provisions of Central Excise Rules, 2002;

(iv) a first stage dealer or a second stage dealer, as the case may be, in terms of the provisions of Central Excise Rules, 2002.

The credit of additional duty of customs levied under sub-section (5) of section 3 of the Customs Tariff Act, 1975 (51 of 1975) shall not be allowed if the invoice or the supplementary invoice, as the case may be, bears an indication to the effect that no credit of the said additional duty shall be admissible.

In 'Flex Engineering Ltd., V. Commissioner of Central Excise, Noida-2008 (12) STR 94 (Tri. Del) it was held that invoices issued by manufacturer to first and second hand dealers who further issued invoices to assessee, are alleged to be not proper documents. As no error / omission / mis-construction has been alleged by the Revenue against assessee no demand sustainable.

In 'Gail India Ltd., V. Commissioner of Central Excise, Indore—2008 (11) STR 538 (Tri. Del) it was held that credit cannot be denied merely on ground that invoices are not authenticated if other particulars are available in the invoice and verified by authorities.

Conditions In Regard To Documents to Avail Credit

No CENVAT credit under shall be taken unless all the particulars as prescribed under the Central Excise Rules, 2002, or the Service Tax Rules, 1994, as the case may be, are contained in the said document.

If the said document does not contain all the particulars but contains the details of duty or service tax payable, description of the goods or taxable service, assessable value, Central Excise or Service Tax registration number of the person issuing the invoice, as the case may be, name and address of the factory or warehouse or premises of first or second stage dealers or provider of taxable service, and the Deputy Commissioner of Central Excise or the Assistant Commissioner of Central Excise, as the case may be, is satisfied that the goods or services covered by the said document have been received and accounted for in the books of the account of the receiver, he may allow the CENVAT credit.

The CENVAT credit in respect of input or capital goods purchased from a first stage dealer or second stage dealer shall be allowed only if such first stage dealer or second stage dealer, as the case may be, has maintained records indicating the fact that the input or capital goods was supplied from the stock on which duty was paid by the producer of such input or capital goods and only an amount of such duty on pro rata basis has been indicated in the invoice issued by him.

The manufacturer of final products or the provider of output service shall maintain proper records for the receipt, disposal, consumption and inventory of the input and capital goods in which the relevant information regarding the value, duty paid, CENVAT credit taken and utilized, the person from whom the input or capital goods have been procured is recorded and the burden of proof regarding the admissibility of the CENVAT credit shall lie upon the manufacturer or provider of output service taking such credit.

The manufacturer of final products or the provider of output service shall maintain proper records for the receipt and consumption of the input services in which the relevant information regarding the value, tax paid, CENVAT credit taken and utilized, the person from whom the input service has been procured is recorded and the burden of proof regarding the admissibility of the CENVAT credit shall lie upon the manufacturer or provider of output service taking such credit.

The manufacturer of final products shall submit within ten days from the close of each month, to the Superintendent of Central Excise, a monthly return in the form specified, by notification, by the Board. Where a manufacturer is availing exemption under a notification based on the value or quantity of clearances in a financial year, he shall file a quarterly return in the form specified, by notification, by the Board within ten days after the close of the quarter to which the return relates.

A first stage dealer or a second stage dealer, as the case may be, shall submit within fifteen days from the close of each quarter of a year, to the Superintendent of Central Excise, a return in the form specified, by notification, by the Board. The first stage dealer or second stage dealer, as the case may be, shall submit the said return electronically.

The provider of output service availing CENVAT credit shall submit a half yearly return in form specified, by notification, by the Board to the Superintendent of Central Excise, by the end of the month following the particular quarter or half year.

The input service distributor shall furnish a half yearly return in such form as may be specified, by notification, by the Board, giving the details of credit received and distributed during the said half year, to the jurisdictional Superintendent of Central Excise, not later than the last day of the month following the half year period.

The provider of output service, availing CENVAT credit or the input service distributor, as the case may be, may submit a revised return to correct a mistake or omission within a period of sixty days from the date of submission of the return, as the case may be.

No Declaration is Required to Avail Credit

In 'DSM Anti-infectives India Limited V. Commissioner of Central Excise, Jallandhar'—2011 (264) ELT 267 (Tri. Del) the credit amounting to Rs. 80,64,129/- of the Additional Customs Duty paid on the goods imported under 11 bills of entry has taken. There is no allegation that bills of entry are not in the name of the appellants or that the inputs in respect of which MODVAT credit has been taken had not been declared in the modvat declaration under Rule 57G. The only objection of the Department is that on the body of the bills of entry, no declaration regarding applicant's intention to avail MODVAT credit had been made as per the provisions of Board's Circular dated 09.12.1986. However, the Tribunal found that there is no provision in the Central Excise Rules pertaining to MODVAT credit that for taking MODVAT credit in respect of the imported goods, the assessee has to make a declaration on the bills of entry regarding his intention to avail MODVAT credit. The department's case is thus without the authority of law and as such, the impugned order denying the MODVAT credit and ordering its recovery and imposing penalty on the appellant is not sustainable.

Supplementary Invoice

Rule 9 (1)(b) provides that a supplementary invoice may be issued by a manufacturer or importer of inputs or capital goods in terms of the provisions of Central Excise Rules, 2002, from his factory or depot or from the premises of the consignment agent of the said manufacturer or importer or from any other premises from where the goods are sold by, or on behalf of, the said manufacturer or importer, in case additional amount of excise duties or additional duty leviable under Section 3 of the Customs Tariff Act, has been paid, except where the additional amount of duty became recoverable from the manufacturer or importer of inputs or capital goods on account of any non-levy or short-levy by reason of fraud, collusion or any willful misstatement or suppression of facts or contravention of any provisions of the Excise Act, or of the Customs Act, 1962 (52 of 1962), or the rules made thereunder with intent to evade payment of duty.

Supplementary invoice shall also include challan or any other similar document evidencing payment of additional amount of additional duty leviable under Section 3 of the Customs Tariff Act.

Rule 9(1)(bb) provides that a supplementary invoice, bill or challan may be issued by a provider of output service, in terms of the provisions of Service Tax Rules, 1994, except where the additional amount of tax became recoverable from the provider of service on account of non-levy or non-payment or short-levy or short-payment by reason of fraud or collusion or willful mis-statement or suppression of facts or contravention of any of the provisions of the Finance Act or of the rules made there under with the intent to evade payment of service tax.

In 'Ultra Tech Cements Limited V. Commissioner of Central Excise, Nagpur'—2011 (22) STR 281 (Tri. Mum) the finding of the appellate authority is—'The issue involved in this case is whether the assessee is eligible to avail CENVAT credit on the supplementary invoices issued by the service providers to him. The service providers of the services to the notice appeared to have not paid the service tax on the account of services provided by them. This non-payment of service tax was subsequently noticed by the department. On being pointed about non-payment of service tax the service providers discharged the tax liability and raised supplementary invoices on the noticee. The credit availed on such supplementary invoices is proposed to be disallowed on the ground that the service provider is not eligible to issue these invoices; and also even otherwise such supplementary invoices are not specified documents under sub rule 1(f) read with sub rule 2 of Rule 9 of CENVAT Credit Rules, 2004, and Rule 4(A) of Service Tax Rules, 1994, for availing CENVAT Credit. The Tribunal held that if the procedural laws are not to be understood in a manner which will deny the rights assured to the parties. Once the assessee is entitled to take credit in relation to the duty paid on the inputs or capital goods and this right being not in dispute, merely because some infirmity observed in the document on which the credit sought to be availed, that cannot be a justification for denying the credit.

Invoice to Indicate Payment of Service Tax

In 'Idea Cellular Limited V. Commissioner of Central Excise, Meerut—I'—2011 (22) 450 (Tri.Del) as regards the service tax credit of Rs. 5,214/- in respect of employee welfare expenses, the Tribunal found that the credit has been taken on the basis of the invoice of M/s Chitra Pal Auto Private Limited and the invoice indicates supply of audio visual equipment. Invoice does not indicate whether the invoice is for service for is for sale of goods. In view of this the Tribunal agreed with the findings of Commissioner (Appeals) that CENVAT credit is not availed on the basis of this invoice. As regards, the service of outdoor catering service i.e., supply of tea and snacks for the staff in respect of which service tax denied is Rs. 4,163/- On going through the invoices of the service provider it is seen that the invoices do not indicate the payment of any service tax and the invoices appear to be just for supply of food and drinks. In view of this the Tribunal upheld the Commissioner (Appeals)'s finding regarding the denial of credit in respect of this item.

Photocopies

The documents on which CENVAT credit is taken should be the original. If it is not original the same may not be allowed by the Central Excise authorities. can Photocopies be utilized for availing and utilizing CENVAT credit? For this question we may refer to the following case laws :

In 'Commissioner of Central Excise, Raipur V. Vandana Energy & Steel Pvt. Ltd.,'—2008-TMI-2507-CESTAT-ND it was held that credit taken based on photocopy is inadmissible. Insistence on document evidencing payment of duty on inputs is not mere technicality to be complied with for availing credit but mandatory to be followed.

In 'Deccan Chromates Limited V. Commissioner of Central Excise, Hyderabad'—2011 (22) STR 440 (Tri. Bang) the CENVAT credit disallowed and demanded relates to credit taken on photocopies of duty paying documents as well as service tax paid on freight incurred for outward transportation. The appellant submitted that he is in possession of original documents which could not be produced before the adjudicating authority and if an opportunity is produced before the adjudicating authority and if an opportunity is provided the appellant will be in a position to submit the original documents to justify the entitlement of CENVAT credit. The Tribunal set aside the impugned order and remanded the matter to the Commissioner for fresh adjudication.

In 'Commissioner of Central Excise, Kolhapur V. Shah Precicast (P) Limited'—2011 (269) ELT 407 (Tri. Mum) the credit was denied based on provisions of Rule 9(1) © of CENVAT Credit Rules, 2004. The assessee's submission was that original copy was not available and police complaint was lodged. The assessee made efforts to obtain certified copy from Commissionerate which was denied. The Tribunal held that there is no dispute that goods suffered duty and used in manufacture. Substantial benefit is not deniable on basis of mere technical violation. The assessee is entitled to CENVAT credit on the strength of Xerox copy.

Thus it can be inferred that CENVAT credit could not be availed on photocopies of documents. It is allowed only on circumstances where original documents could not be produced before the Central Excise Authorities which is beyond the control of the assessee.

Procedural Lapse

In some cases the CENVAT credit may be disallowed on procedure lapse. In 'Commissioner of Central Excise, Bangalore—III V. Saturn Industries'—2011 (267) ELT 609 (Kar) the Court held that the benefit was denied only on the ground of non-compliance with the rules and coupled with the fact that the delivery notes is not the satisfactory document. The Board's Circular No. 441 / 7 / 99-CX, dated 23.2.99 has clarified that mere not following the procedure cannot form the basis for rejecting the assessee's claim to avail MODVAT credit especially when sufficient evidence about the duty payment on inputs and usage in the manufacture of excisable goods were available on records. The question of law is answered in favor of the assessee and against the revenue.

TR-6 Challan

In 'Commissioner of Central Excise, Meerut—II V. Hindustan Coco Cola Beverages (P) Limited'—2011 (22) STR 292 (Tri. Del) the respondents availed CENVAT credit of service tax paid during the period from April 2005 to March 2006 based on the TR-6 challans under which the respondents themselves paid service tax as deemed service provider. The Original Authority has held that prior to 16.6.2005 TR-6 challans are not prescribed documents for taking CENVAT credit. The Commissioner (Appeals) set aside the order of the original authority. The Tribunal held that generally the person who pays the service tax is different from the person who takes the CENVAT credit and therefore credit is being taken based on such third party documents. In the present case TR-6 challan has been used for paying service tax by the respondents themselves. There is no dispute about the payment of service tax by the respondents and that as recipients they are entitled to the credit. There can be no difficulty for the department in verifying the correctness of the credit taken as the deemed service provider and the person who has taken the credit are one and the same person.

In 'Cosmos Casting India Limited V. Commissioner of Central Excise, Raipur'—2011 (23) STR 144 (Tri. Del) the tribunal held that the only question is that TR-6 was not specified document for the purpose of taking CENVAT credit. When there is no dispute about the realization of the demand by the exchequer the technicalities shall not be a bar to deny credit to the assessee.

Further, the rule provides that a challan evidencing payment of service tax is considered as a valid document. Thus TR-6 challan may be utilized as a document for the purposes of CENVAT credit.

Credit Available Only to Recipient of Service

In 'Khaitan Electricals Limited V. Commissioner of Central Excise, Kolkata VI'—2011 (21) STR 184 (Tri. Kol) credit was taken based on document on service received by depot. The unit of Jaipur was not registered as input service distributor and service tax credit is not available to manufacturing unit at Kolkata, according to the department. The Tribunal held that the appellants who availed the credit are not the recipient of the taxable service, the taxable service is received by the depot and depot is not registered as an input service distributor. Therefore, the appellants are not entitled for credit at Kolkata unit which was in respect of service received by the depot at Jaipur.

CENVAT Credit to GTA Services

In 'Commissioner of Central Excise, Jaipur II V. Rajasthan Spinning and Weaving Mills Limited'—2011 (22) STR 52 (Tri. Del) the Department held that the assessee could not use the CENVAT credit account for paying service tax on GTA services. The Tribunal held that the credit has been taken by the respondents in respect of the inputs and input service under Rule 3 of CENVAT Credit Rules, 2004. It is not disputed that the respondents were required to pay service tax on GTA services. In the case of GTA, the person required to pay service tax may be the supplier of the inputs or the recipient of input or the service provider themselves. If the supplier of inputs paid freight and consequently paid service tax, based on the documents issued by the said supplier of inputs, the credit on the inputs as well as on the service tax paid would have been available to the respondents as recipients. The recipient has paid the service tax as deemed service provider in terms of Section 68 of the Act were also the recipients of GTA services. As both service provider of services and recipient of services, dual role has been played by the respondents and therefore the documents based on which the respondents have taken credit has been held to be valid. If the recipients are held to be service providers, then, in the present circumstances they are providers of self service to themselves. Therefore, the objection of the department about the documents based on which the credit has been taken by the recipients are not valid.

Documents not in the name of Assessee

In 'SGS India Private Limited V. Commissioner of Central Excise, Thane—I'—2011 (270) ELT 115 (Tri. Mumbai) one of the grounds for denying CENVAT credit is that the appellants have availed CENVAT credit on the basis of various bills of entry wherein the name of the importer given as M / s SGS India Private Limited, Usha House, 210 Okhla Industrial Estate, Phase III, New Delhi indicating that the inputs covered by the said Bills of Entry were received at the assessee's other unit. The Department was of the view that the assessee was not entitled to take the credit on the strength of the Bills of Entry unless and until its entries are in the name of the person who is taking the credit. The Tribunal held that the input covered in the Bills of Entry have been received in the factory of the appellant. The order of denial of credit on the ground of the bills of entry are not in the name of the appellants is not sustainable.

In 'Millipore India Private Limited V. Commissioner of Central Excise, Bangalore'—2011 (21) STR 582 (Tri. Bang) the input service tax credit taken by the appellant has been denied on the sole ground that the invoices against which credit were availed had not been addressed to the appellant's manufacturing unit and the procedure for distribution of credit as prescribed in Rule 7 of CENVAT Credit Rules. The Tribunal held that the Revenue has no case that the assessee has taken credit in excess of what was shown on the invoice or that the assessee was engaged exclusively in the manufacture of exempted goods or production of exempted service. The appellant has made out a prima facie case against the impugned demand and penalties.

Tampering of Documents

In 'Rajalakshmi Paper Mills Limited V. Commissioner of Central Excise, Madurai'—2012 (25) STR (Tri. Chennai) the appellants have been denied input credit and capital goods credit on the ground that the impugned goods which were consigned to Unit I of the appellants were utilized in Unit II of the appellants located in the same premises after the appellants themselves altering the excise code number on the relevant invoices and also writing Unit II on the said invoices. The Tribunal held that the denial of credit is primarily on the basis of the allegation of tampering with the duty paying documents and not on the ground of either non-receipt of the impugned goods in the factory of the appellants nor on the basis of non-utilization of the same. In view of the fact that the assessee is same even though two separate regions have been taken for the two units stated to be located in the same premises, and that there is no allegation of either non-receipt or non-utilization of the impugned duty-paid good, the Tribunal is of the view that as regards the eligibility to CENVAT credit, a lenient view should be taken and the appellant should be allowed to avail the impugned credit.

Conclusion

The provisions of Rule 9 give a clear picture on documents on which CENVAT credit may be taken and utilized. The original documents are required for this purpose. Since the documents are to be submitted to Adjudicating authorities or to be produced at the time of audit conducted by the Audit wing of Central Excise department.

The documents on which the credit is taken are to contain the full details as required under the provisions of Central Excise or Service tax—as the case may be. ❒

Salient Features and Observations on CARR (Pharmaceutical Industry), 2011

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Cost Accounting Records (Pharmaceutical Industry) Rules, 2011, are in supersession of Cost Accounting Records (Bulk Drugs) Rules, 1974, and Cost Accounting Records (Formulation) Rules, 1988. So, the new Rules have combined the Records Rules of Bulk Drugs & Formulation Industry.

2. Rule 2 — Definitions & Interpretations—Sub Rule(1) — Definition of 'Pharmaceutical activities' has been linked to DPCO, 1995, as well as Chapter 29 & 30 of the Central Excise Tariff Act, 1985, and further includes intermediate products and allied products thereof.

Chapter 29 covers various types of organic chemicals, in addition to Bulk Drugs. Organic & Inorganic Chemicals under Chapters 28, 29, 32 and 39 have also now been covered under cost audit order dated 24/01/12 and, consequently, chemicals—whether for Bulk Drugs or otherwise—are also subject to automatic Cost Audit under these Rules, in addition to the existing Bulk Drugs.

Sub Rule (o)—The term 'turnover' shall include turnover from job-work or loan license operations, but exclude Excise Duty, ST, VAT & other taxes & duties (as per CAB general Circular No.68/2011 dated 30.11.2011—Para (c)) and also includes Export Incentives.

3. Rule 3 —Application—Earlier exemption from the rules was given to SSI Industry with valuation limit of Plant & Machinery as per IDR Act and turnover limit of Rs. 10 crores, which have been deleted now.

Now the applicability of the Rules is based on the following criteria :

- Net Worth exceeding Rs. 5 crores, or
- Turnover exceeding Rs. 20 crores, or
- Equity or debt securities listed or in the process of listing on any stock exchange in or outside India.

4. Rule 4 —Maintenance of Records—These Rules shall be applicable for the financial year commencing on or after the date of this Notification (i.e. 7.12.2011). In effect they will be applicable for most of the companies for the financial year 2012-13.

Rule 4(b)—Those companies which are coming under Records Rules for the first time shall preserve cost records for 8 financial years, commencing from the period starting from the year to which these Rules have become applicable to them (CAB General Circular No. 68/2011 dated 30.11.2011—Para b & FAQ 4, Point 4.4 of ICWAI).

5. Rules 5, 6 & 7—Compliance Report—If the company is subject to Cost Audit for 100% of its activity, or in addition having only trading/service activities, then the requirement of the Compliance Report is not applicable for such companies. For other companies, which are engaged in manufacturing other products, not subject to Cost Audit (in addition to Pharmaceutical products which are subject to Cost Audit)—in such situations the company is subject to the requirement of the Compliance Report, as per GSR 429 dated 3.6.2011 [The Companies (Cost Accounting Records) Rules, 2011] or any of the other 5 Cost Accounting Records Rules for Regulated Industries.

6. General—In the earlier Rules, Para-wise requirements of various items, such as materials, salary & wages, service department expenses ... up to technical information were mentioned as per Schedule I/ Schedule III, which have been deleted.

The following observations and suggestions are made keeping in view Note 7 given in the end :

7. Proforma A—Part I—Quantitative Information—After Sr.6, one more Item may be added for 'quantity transferred to other units and sold to outside parties', if necessary.

Part II Cost Information—After Sr. 13, following items may be added, if found necessary—

Sr. 14. Less : Cost of transferred to other units.
Sr. 15. Less : Cost of sales to outside parties.
Sr. 16. Net cost for self-consumption.

Clarification for—Srs.14 & 15: Quantity should be valued **at cost** and not at transfer price or sale price. Difference in value should be transferred to Profit Reconciliation Statement.

8. Proforma B—This proforma is to be filled up for quantitative and technical information only. This format has been rationalized & simplified. Sr.1 to 4 are for **factory as a whole** and not productwise.

Sr.2(c)—'Under loan licence', means company **has manufactured for others** under Loan License scheme.

Information for Sr.5 shall be given separately for each intermediate or Bulk Drug.

Material consumed & process chemicals—Item-wise details may be separately shown covering 80% in value.

9. Proforma B-1—This proforma is to be filled up for **value** corresponding to **quantitative information** filled up in Proforma B. Information shall be given separately for each intermediate or Bulk Drug.

Part I—Quantitative Information—Sr.1—In case of numerous batches with different batch sizes, range could be given (e.g 1 to 4MT).

Part II—Cost Information Srs. 1 & 2—Material consumed & process chemicals—Item-wise details may be separately shown covering 80% in value.

Sr.5—Direct expenses may also include outside job-work charges paid.

Sr.10—Technical Know-how Fee may also include Royalty.

Sr.12—**Other Production Overheads** should be classified according to the definition provided in the Cost Accounting Standards. Accordingly, Administration overheads for production would already be considered as a part of production overheads and the same would be in line with CAS-4 Certificate for Excise Purpose.

Sr. 14—Opening/closing stock in process should also include **unpacked stock**.

Cost of Production Statement shown in this Proforma is for naked production. The Cost of Packing has been considered under Proforma C.

10. Proforma C—Information shall be given separately for each intermediate or Bulk Drug. Even within the same intermediate or Bulk Drug, separate statements should be prepared for export sale, domestic sale, sale at DPCO price, and sale to related parties.

Part I, Sr.2 & Part II, Sr.4—Opening & closing stock of unpacked is normally grouped under stock in-process. However, under the present Rules, the Stock has been shown under three distinct stages—Stock-in-process, Unpacked Stock and Packed Stock.

11. Proforma D—This is newly introduced Proforma for Bulk Drugs or Formulations got **manufactured from outside** (on job charges basis). Information shall be given separately for each intermediate, Bulk Drug or Formulation. Further, separate Proforma should be prepared for each Job Manufacturer.

Part I Quantitative information—as per Srs. 1 to 8 should be as per records/status with the job manufacturer.

Sr. 4—Material consumed means quantity issued to the shop floor for manufacture.

Part II, Sr.1—It should be corresponding to Part I, Sr. 4 in value for quantity issued to shop floor.

Sr.2—Processing charges—It should be treated as **processing charges payable** corresponding to the quantity received from the processor as per Sr.9.

Sr.7—Packing material cost—It should be corresponding to Part I, Sr. 4, in value for quantity issued to shop floor.

Similar to Proforma C for Bulk Drug & Proforma G for Formulation for **Statement showing Cost of Sales, Realisation & Margin**, there is no prescribed statement for quantity sold on job charges basis.

Therefore, it is suggested to carry forward this statement to Proforma C & Proforma G for Bulk Drug & Formulation, respectively.

12. Proforma E—Additional column should be provided for Bulk Drugs activity, Formulation activity and Interest.

The line items provided in this Proforma are indicative and has to be modified according to necessity and accounting structure of the Company. Srs. 36 to 40 have shown certain items which are indicative to show the flow of cost allocation and apportionment and the same may be restructured according to the secondary allocation process required for the company concerned. Separate statement for apportionment of cost of various service cost centers to production cost centers may be prepared—keeping in mind the structure provided in the Proforma.

13. Proforma F—There seems to be drafting error in this Proforma from columns 11 to 14. It should have been **packing cost centers** (separately for tablet, capsule, syrup etc. — Note 15 below Proforma I).

14. Proforma G—This statement should be separately prepared for each type & size of pack of Formulation and, again, separately for own manufactured, got manufactured from outside parties (on P to P or LL) and manufactured for others under job-work arrangement in the factory.

Sr. 5—Batch size—It should be shown in the range, if there is varying batch size for different batches.

Srs. B & D—Primary packing cost & Srs. J & K—Secondary packing cost—As per normal practice in Pharma Industry, they cannot be separately shown.

Sr. D—Packing cost—It should be read as primary packing conversion cost.

Sr. G—Opening / Closing WIP should be considered before Sr. D.

Sr. K—It should be read as secondary packing **conversion** cost.

Sr. S-1—It should be read as selling & distribution cost.

Sr. S-2—**Sample cost** should be included under sales promotion expenses.

Sr. V—It is not understood as to how 'other expenses or income not included in cost' can be shown in product-wise cost statement. It should be considered as reconciliation item.

15. Proforma H—It is a newly introduced Proforma. Fixed Asset Schedule should be restructured to fill up this Proforma.

16. Notes—Vide note Nos. 7 & 11, Proforma can be modified.

Note 8—As per this note, expenses incurred for getting accreditation from Overseas Regulatory Authority shall be charged to products exported on scientific & equitable basis.

Note 16—The impact per unit of abnormal loss has to be shown separately as per this note. However, as per Generally Accepted Cost Accounting Principles, the cost of abnormal loss is omitted from cost records. So there is no question of calculating and indicating its impact per unit.

Conclusion

In view of Notes 7 & 11, liberty is given to company to modify the Proforma. Therefore, it is suggested that company can continue with the existing working papers and other formats for cost records which are in vogue and can continue to use existing computer programme or excel software, based on the existing Cost Accounting Records Rules for Bulk Drugs & Formulations. Anyway, from the existing cost records, Para 5—Abridge cost statement (for each product group) can be prepared, which is, ultimately, to be submitted to the Government along with e-filed Cost Audit Report. ❐

FOR ATTENTION OF MEMBERS

The fees payable by the members of the Institute have been revised by the Council with effect from 1st April, 2012 from the financial year 2012-2013 onwards as follows :

Category of fees	Amount Payable
Associate Entrance Fee	Rs. 1,000/-
Associate Membership Fee	Rs. 800/- p.a.
Fellow Entrance Fee	Rs. 1,000/-
Fellow Membership Fee	Rs. 1,500/- p.a.
Certificate of Practice Fee	Rs. 1,000/- p.a.

The fees payable by the retired members entitled to pay at reduced rate in pursuance of Regulation 7 (4) of the Cost and Works Accountants Regulations, 1959 with effect from 1st April, 2012 from the financial year 2012-2013 onwards shall be as follows :

Category of fees	Amount (Rs.)
Associate Membership Fee	Rs. 200/- p.a.
Fellow Membership Fee	Rs. 375/- p.a.

Is the Union Budget of India (2012-2013) Realistic and Achievable?

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Budget proposal of any financial year is a projected statement of sources and applications of fund of the government for that year.

One would get a different picture of this year's budget, if it is analysed in the way, financial analysts analyse projected statement of income and expenditure of a company. In order to make the projections realistic, financial analysts do trend analyses and variance analyses of historical data to finalize basic assumptions underlying the future projections so that the projections become realistic and achievable.

Adopting the same method, trend analyses of the past data (2006-07 to 2011-12) shows that the Centre's net tax revenue (NTR) as percentage of GDP was 10% in 2006-07 which increased to 12% in 2011-12 (mean value 11%). Non-tax revenue as percentage of GDP, which was 3% in 2006-07 decreased to 2.4% in 2011-12 (mean value 2.70%). Mean value of total revenue receipt (TRR) during the same period was 13.50% of GDP, while the mean value of total capital receipt (TCR) during the period was 7.50% of GDP. Mean ratio of TRR and TCR during the reference period was 2.20 indicating TCR was about 45% of TRR. Though debt receipt (DR) as percentage of TCR decreased from 96% (2006-07) to 95% (2011-12), mean value was about 96%. However, DR as percentage of total receipt (TR) increased from 25% (2006-07) to 40% in 2011-12(mean value 32%). Compared with GDP, DR increased from 4% to 10% during the reference period. This shows that DR is not only the main source of capital receipt (long term sources of fund) but also it indicates centre's increasing reliance on outside debt. Interest payment as percentage of revenue expenditure remained at about 24% from 2008-09 to 2011-12. The same as percentage of GDP remained constant at about 5%. Such decline does not indicate favourable situation if one analyses with reference to higher incremental growth rate of revenue expenditure compared to that of interest payment. Both these features are clear symptoms of reducing debt servicing capacity (DSC) and Interest servicing capacity (ISC).

Looking at the behaviour of revenue expenditure (RE), it is observed that during the reference period, RE as percentage of GDP remained at about 22%.

On the other hand, capital expenditure (CE) as percentage of GDP increased to 3% from 2%, with a mean of 2.5%.

Trend analysis of revenue deficit (RD) and fiscal deficit (FD) showed that both these important indicators of economy increased with reference to GDP; the former increased to 7.6% from 3% of GDP, while the later increased from 4% to 10%. Interestingly, while GDP growth rate (average y-o-y) was about 7%, the same for total expenditure (TE) was about 20%. This is another alarming situation. Rate of increase in income is less than rate of increase in total expenditure. This leads to more dependence on outside borrowings which might impair sovereignty of a country. This, coupled with declining DSC and ISC, are deterring factors for sustainable growth. That India is leading to such a situation is clear from the deteriorating DSC and ISC. Moreover, DSC and ISC shown in the union budget appear to have not been calculated in line with the method adopted by financial analysts. DSC of a country should be an indicator showing how much of the total borrowings and other liabilities a country can pay on demand from TRR. ISC should indicate how much of interest payment can be made from interest collected. DSC should be collected as a ratio between TRR and borrowings and other liabilities of that year. ISC is a ratio between amount of interest receipt, dividends and profits to amount of interest payments and prepayment premiums in a year. On this basis, DSC decreased from 3.05 to 1.96 and ISC decreased from 0.34 to 0.25 during the reference period.

Now, let us see what is revealed from variance analysis. Variance analysis for the reference period shows interesting features. While receipts showed favourable variance, expenditures showed adverse variance. Both actual receipts and expenditures were more by about 5%. Gap between long term sources of

Table 1 : A comparative picture of the Union Budget (2012-13)

(Rs. in crores)

Sl. No.	Components	Realistic estimate on the basis of trend and variance analyses	Amount shown in the Union Budget
a.	Net tax revenue (11% of GDP)	614633	771071
b.	Non-tax revenue (2.70% of GDP)	150864	164614
c.	Total revenue receipt (TRR) (a + b)	765497	935685
d.	Capital receipt (CR) (45% of TRR)	344474	555241
e.	Total receipt = [(c+d) + 5% of (c+d)]	1109971+55499 =1165469	1490925
f.	Revenue expenditure (RE) (22% of GDP)	1229265	1286109
g.	Capital expenditure (CE) (2.5% of GDP)	139689	204816
h.	Total expenditure = [(f+g) + 5% of (f+g)]	1368954+68448 =1437402	1490925
i.	Total interest payment (24% of revenue expenditure)	295024	319759
j.	Revenue deficit (c – f)	463768	350424
k.	Fiscal deficit [(h-(c+Loan recoveries+Other receipts)]	653330	513590
l.	Primary deficit (k – i)	358306	193831

(Note: On the basis of past trend, GDP will grow at the rate of 7% during 2012-13. This means GDP would be Rs. 5587569 crores during the financial year 2012-13. Further, in absence of actual data for 2011-12, revised estimate has been considered as nearer to actuals.)
Source: http:/indianbudget.nic.in

fund (LTS) and long term application of fund (LTA) widened leading to increasing trend in revenue deficit (RD). This RD, in the language of a financial analyst, is deficit in net working capital (NWC) of an entity. More will be the gap, more would be the deficit in funds required to run the government.

Now, let us look at the Centre's efficiency of collecting interest due on loan given by it. An index may be found out to determine the efficiency of the government for this purpose. Amount of interest received during a particular year as a percentage of mean value of total loan outstanding at the beginning and at the end of that year may be considered as efficiency index for interest collection (EIIC). On this basis, it is observed that EIIC which was 0.08 during 2007-08, declined to 0.03 during 2011-12 showing an unfavourable situation.

Now, let us see what should have been the realistic picture of the Union Budget (2012-13) on the basis of underlying assumptions arising from the results of the trend and variance analyses given as above. Table 1 gives a comparative picture.

It would be revealed from Table 1 that components of Union Budget appear to be not realistic and achievable. The main difference lies in the revenue deficit, fiscal deficit and primary deficit. Amount of revenue deficit, fiscal deficit and primary deficit would be much more than projected in the Union Budget. These deficits are likely to be met by borrowing more from the markets and by other means, or by curtailing the expenditure in important sectors, namely, education, health, infrastructure, agriculture etc. Such a step is not only against the public interest but also reduces both debt and interest servicing capacity of the government.

Central government should thus pay much attention to such an important issue while preparing the budget. ❐

Sustainable Growth in Indian Jute Industry—An Exploratory Study

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Introduction

Today's environment-conscious industrial world puts much more efforts on eco-friendly projects and concentrates more on production of bio-degradable products. Jute is one of those products, which is purely of bio-degradable and eco-friendly in nature and hence, it has found many uses in recent times. Jute is one of the largely cultivated crops in India, and it occupies an important position in Indian agriculture. Jute is popularly known as the 'Golden Fiber' for its numerous uses. Traditionally, jute is mainly used as packing materials in the manufacturing industries like sugar, cement, food grain etc., but with time many diversified jute products have come into use and now jute is being increasingly used for manufacturing of many fashionable household products of daily use like mat, bag, fabric, carpet, cloth, curtain etc. Indian Jute Industry is the largest producer of raw jute and jute products in the world. India holds the second largest position internationally as regards export of jute goods. Jute plays a very important role in Indian economy. India's textile industry is mainly dependent on jute. Apart from having huge export potential, the jute companies meet domestic needs as well. The government of India has taken many major supportive steps for the protection and growth of this industry. It has set up different authorities and legislative councils for successfully maintaining various acts and schemes to protect jute industry from losing its existing market. To name a few, the Jute Manufactures Development Council (JMDC), Centre Research Institute for Jute and Allied Fabrics, Indian Jute Industries Research Association (IJIRA), Indian Jute Mills Association (IJMA) etc. are such efforts made by the government. The Indian jute sector comprises of two parts, namely, organized sector and unorganized sector. Organized sector dominates this industry in India by contributing maximum in terms of employment generation and production of jute products. It has an average annual production of 1.6 million metric ton of jute products with 78 jute mills and creates employment to near about 4 million families, whereas the informal or unorganized sector has 700 registered units and creates employment to 63000 families [Source: http://www.jute.com]. Data collected from the International Jute Study Group, available at www.jute .org suggest that India takes a major share in World's jute production by producing 1.95 metric ton jute per hectare and occupying an average land area of 8,36,000 hectares annually. At the same time it generates an export quantity of 2, 02,000 metric ton jute goods, valuing US$ 246 million each year.

Therefore, this paper aims at examining the growth and sustainability of Indian jute industry. Section 2 of the paper highlights the present scenario of Indian jute industry in terms of its production, jute producing states, number of jute mills etc. Section 3 represents the future scope and opportunities of jute industry in India and examines future sustainability of Indian jute industry. Section 4 discusses the recent developments and regulative measures in the concerned industry in India and the paper ends with conclusions in Section 5.

Present Scenario of Indian jute Industry

This section has been compartmentalized into two parts : (a) discusses the state- wise distribution of jute mills in India and (b) shows state-wise raw jute production in India.

(a) State-wise distribution of jute mills

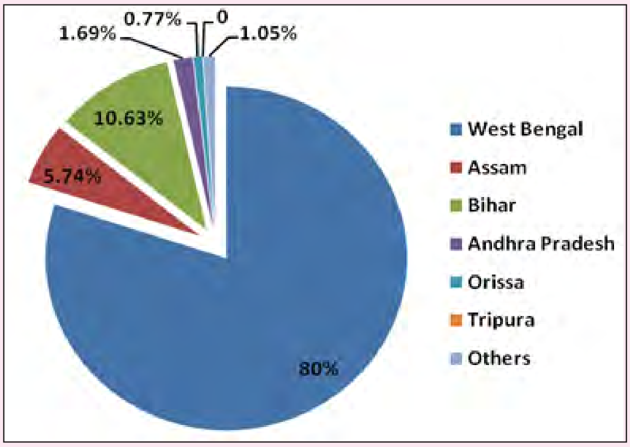
The major jute producing states in India are West Bengal, Assam, Bihar, Orissa and Andhra Pradesh, but the Indian jute industry is mainly dependent on West Bengal wherein this industry had begun in 1854 with the setting up of the jute mill by George Auckland at Rishra in Hooghly district. As per the National Jute Board, India records, there are 80 jute mills in India at present, out of which 62 belong to West Bengal, 7 belong to Andhra Pradesh, 3 belong to Bihar and Uttar Pradesh each, and Assam, Orissa, Madhya Pradesh and Tripura have 1 jute mill each. But the crucial fact is that, out of these 80 jute mills of India, 11 jute mills are not working, and 31 jute mills are referred as sick by the Board for Industrial and Financial Reconstruction of India (BIFR) [Source: Jute Commissioner, Ministry of Textiles, Government of India]. The following exhibit (Exhibit 1) will represent the state-wise distribution of jute mills in India more clearly :

Exhibit 1
Distribution of Jute Mills in India

State	Number of Jute Mills	BIFR Cases	Mills Not Working
West Bengal	62	27	8
Andhra Pradesh	7	1	1
Bihar	3	1	1
Uttar Pradesh	3	1	1
Assam	1	—	—
Orissa	1	1	—
Madhya Pradesh	1	—	—
Tripura	1	—	—

(b) State-wise production of jute in India

Exhibit 2
State-Wise Production of Raw Jute



The above exhibit (Exhibit 2) is based on the figures of raw jute production in the year 2009-10 and it clearly shows that West Bengal shares the major portion of raw jute production in India It indicates that West Bengal itself produces 80% of total raw jute production of India during 2009-10, whereas Bihar is at second place with 10% of total production, followed by Assam and some other states. Experience suggests that the jute industry of West Bengal had flourished in the past, and though it holds the first position as regards raw jute production in India, but for the last few years it has been facing ups and downs and condition of the other states is also not very satisfactory. The annual per hectare yield of raw jute in Bangladesh and China are 2.32 metric ton and 2.67 metric ton respectively, while India's annual yield of raw jute is 1.95 metric ton per hectare [Source: International Jute Study Group, available at www.jute .org]. If this trend of low productivity of raw jute per hectare keeps continuing in India, then it will certainly damage Indian jute market. Therefore, the state-wise production of raw jute in India should have to be increased to cope with the increasing national and international demand for jute products.

Sustainability of Indian Jute Industry

This section has been compartmentalized into two parts to depict the growth of Indian jute industry in terms of its production of raw jute and export of jute goods to analyze its future sustainability. Part (a) shows growth of Indian jute industry in terms of production of raw jute and part (b) highlights growth of Indian jute industry as regards its export of jute goods.

(a) Growth as regards production of raw jute

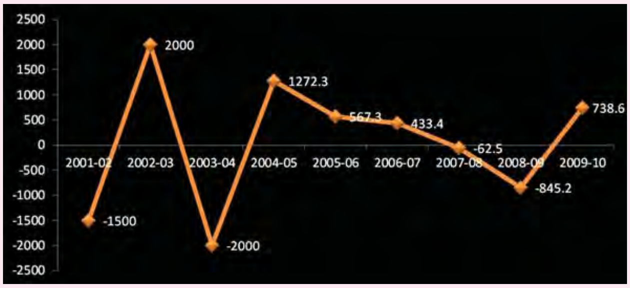
India being the largest producer of raw jute has huge potential for its jute industry. The following exhibit 3 shows the total production of raw jute in India and its growth rate since 2001-02, as per the data collected from the Jute Commissioner, Ministry of Textile, Government of India:

Exhibit 3
Production and Growth of Raw Jute

Year	Production (000' Bales)	Growth (000'Bales)
2001-02	9000	–1500
2002-03	11000	2000
2003-04	9000	–2000
2004-05	10272.3	1272.3
2005-06	10839.6	567.3
2006-07	11273	433.4
2007-08	11210.5	–62.5
2008-09	10365.3	–845.2
2009-10	11103.9	738.6

From the above exhibit (Exhibit 3) it is quite clear that raw jute production in India has witnessed an up and down trend since 2001-02. During the 2000-01, total production of raw jute in India was 10500x1000 bales. It has registered a significant increase in the years 2002-03, 2004-05 and 2009-10 relative to their respective previous years. However, it showed a nominal increase in 2005-06, 2006-07 and a negative growth in raw jute production in 2001-02, 2003-04, 2007-08 and 2008-09. The main reasons for such inconsistent growth in raw jute production in India are insufficiency of adequate capital, poor quality seeds and scarcity of water. For all these reasons, total production of jute in India follows an inconsistent pattern every year, and as a result, though India occupies a major share in World's jute production and export, it is far behind the optimum level that could be achieved, if the problems of this industry are identified at an early stage and curative measures are taken. It is, therefore, imperative to identify the causes of such downsides of the jute industry in India so that preventive measures can be suggested. However, the following exhibit (Exhibit 4) will show more clearly the inconsistent growth pattern of jute production in India through a line chart :

Exhibit 4
Trend of Jute Production in India



(b) Growth as regards export of jute goods

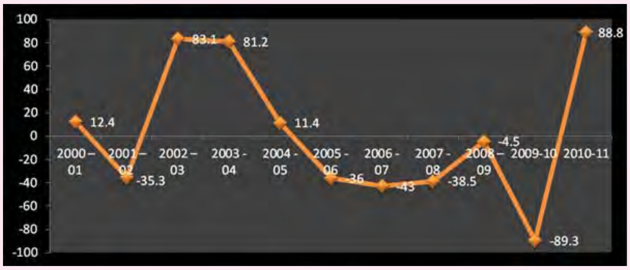
India holds the second largest position as regards export of jute goods in the World. The next exhibit (Exhibit 5) shows total volume of export of jute goods of India in terms of quantity and value from 2000-01 to 2010-11. Accordingly, the two subsequent line charts represent the trend of India's export growth as regards jute goods in terms of its quantity and value since 2000-01 [Source: Jute Commissioner, Ministry of Textile, Government of India].

Exhibit 5
Export of Jute Goods in Terms of Quantity and Value

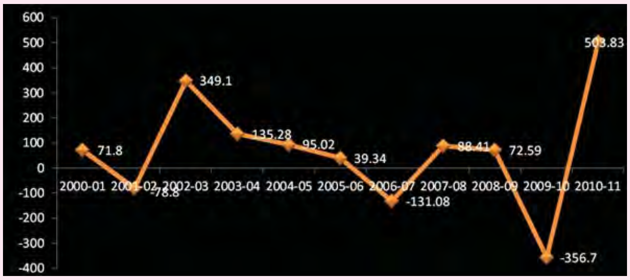
Year	Export (000'M.T)	Growth (000'M.T)	Export Rs (Cr.)	Growth Rs (Cr.)
2000–01	181.4	12.4	646.3	71.8
2001–02	146.1	–35.3	567.5	–78.8
2002–03	229.2	83.1	916.6	349.1
2003–04	310.4	81.2	1051.88	135.28
2004–05	321.8	11.4	1146.9	95.02
2005–06	285.8	–36	1186.24	39.34
2006–07	242.8	–43	1055.16	–131.08
2007–08	204.3	–38.5	1143.57	88.41
2008–09	199.8	–4.5	1216.16	72.59
2009–10	110.5	–89.3	859.46	–356.7
2010–11	199.3	88.8	1363.29	503.83

M.T= Metric Ton and Cr. = Rs in Crore

Exhibit 6
Trend of Jute Export from India (Quantity)



Trend of Jute Export from India (Value)



The above exhibit (Exhibit 5) shows that total export of jute goods from India in terms of quantity has shown a decreasing trend from 2005-06 and continued up to 2008-09, but during 2009-10 it has slightly improved over the last year i.e. 2008-09 and in terms of value the picture is also not very bright. It has seen negative growth in the years 2001-02, 2006-07 and in the recent past i.e. 2009-10. But luckily during the last financial year 2010-11 it got in to the positive track and registered a growth in terms of its quantity and value together. On the other hand the trend lines in the above exhibit (Exhibit 6) depict the same inconsistent behaviour of Indian jute industry similar to that of raw jute production in exhibit 4. From the above analysis the problems of Indian jute industry can be indentified and summed up as follows :

- jute industry in India mainly suffers from inadequate supply of capital, raw material, scarcity of water and dearth of skilled labour etc;
- jute mills in India generally follow traditional methods for producing jute products which involve high production cost;
- old infrastructures of the jute mills reduce total production of jute goods continuously;
- competition from the other Asian countries like China, Bangladesh is increasing rapidly;
- low cost jute products from other Asian countries are capturing international market;
- lack of proper administration and governance system encourages jute mills to attract financial anomalies more quickly;

- dearth of proper agricultural strategies and rapid urbanization are putting harm full effects on jute cultivation in India largely;

However, the government of India is trying hard to protect this ancient industry from losing its existing market nationally and internationally. It has set up a number of organizations, legislative councils to protect Indian jute industry from international competition by improving the standard and quality of the jute products and introduced various acts to create social awareness for encouraging use of jute products. The next paragraph will highlight different activities that are being taken up in India to create an environment so to give this premier industry a boost to sustain for many years to come.

Steps for Future Sustainability of Indian Jute Industry

The general objective behind setting up of different organizations is to watch and monitor the growth of the jute industry in India and take necessary steps for helping this industry to sustain. Institutes that generally carry on different researches on how to increase the demand of jute goods by developing new variety of jute products in India are namely Centre Research Institute for Jute and Allied Fabrics, Indian Jute Industries Research Association (IJIRA), Indian Jute Mills Association (IJMA), Jute Manufactures Development Council (JMDC) etc. The main acts that control and regulate jute industry in India and encourage use of eco-friendly jute products are Jute Packaging Materials Act 1987, Jute Manufacturers Cess Act 1983, and National Jute Board Act 2008 etc. In spite of these organizations and acts, the government of India has introduced some specific orders and rules for controlling the market competition and making it compulsory for some industries to use jute packaging. Some of the orders and rules are Jute and Jute Textiles Control Order 2000, Jute and Jute Textile Control (Amendment) Order 2005, Notification for withdrawal of minimum Order 2006, and Jute Manufactures Development Council (JMDC) Procedural Rules 1984, Jute Packaging Materials Rules 1987 etc respectively. More specifically, the government with all its organizations, acts, orders and rules should look into the following issues for maintaining a consistent growth in the concerned industry to help it sustain in coming years :

- an in depth analysis of the legal provisions and other regulatory measures regarding financial matters, especially those applicable to the jute mills in India;
- identification of the disclosure and reporting aspects of financial matters in relation to the jute companies;
- assessment of the need for diagnosis of financial anomalies, if any in Indian jute industry and proper efforts should also be made to find out the possibility of its revival;
- measurement of the financial performance, signals and effects of financial anomalies in jute industry in India;
- eradication of the reasons responsible for inconsistent financial performance of the jute mills in India in recent years, to the extent possible;
- strategies for judging the financial stability of the existing jute mills currently operating in India;
- implementation of appropriate packages of restructuring and rehabilitation strategies for jute industry;

Conclusions

Jute industry is one of those industries which depends largely on the external factors than the internal issues and hence likely to attract financial anomalies more quickly. If the above identified problems remain unsolved, then these may lead to several problems for Indian jute industry like under utilization of capacity, poor surplus generation, decline in net worth etc and ultimately affect its sustainability. Therefore, the sooner these problems are appropriately addressed, the lesser will be the probability for Indian jute industry to lose its sustainability. Indian jute industry is facing two big challenges in recent times which are high production cost and inadequate supply of capital. Therefore, new technologies should be introduced to produce standard jute products at low cost to capture the growing international market. Besides, supply of raw material should be brought under control, labour rate should be held in check, and proper policies are to be framed to maintain a sustainable growth. Experience suggests that the jute industry in India had flourished in the past because of its favourable environment, availability of labour and demand of its jute products from national and international markets etc. Therefore, chances are still there to make Indian jute industry a grand success and for this purpose some true initiatives as suggested above, need to be taken to replace this present inconsistent growth by a consistent one and hence help the industry grow further and sustain for a longer period.

Diagnosing BSNL As A Business—Performance Analysis of A Fully Owned Government Company—A Case Study of Bharat Sanchar Nigam Ltd.

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Stakeholder's point of view

In looking into firm level financial performance, generally analysis is concerned with two sets of performance measures. One based on capital market valuation of a firm and the other set based on accounting measures of profitability and financial performance.

Our method is to approach the issue from a stakeholder's point of view. Stakeholders in BSNL are: Government of India, Customers, Regulatory Agencies, Suppliers and the General Public. The traditional way of defining Stakeholders also does not seem to hold valid for BSNL because the objectives of the Government (as the only investor) is far beyond the short-term goals of financial returns of value maximization.

With the opening up of the Telecommunications sector in India, the Consumers as a stakeholder acquires a different meaning, and it becomes the focus of all marketing and innovation of all operators in the sector. The same could be said of the suppliers and the peripheral equipment vendors. We can then argue that the most important stakeholders in BSNL are in fact its own Employees. Our attempt will then try to focus on an assessment of the Company's performance that views financial performance from the perspective of the Employees. At the same time we wish to point out that it cannot offer a complete perspective because employees have much more at stake than just financial issues before them.

Justification of the Topic

In the era of Globalization, Liberalization and Privatization the challenges faced by the Public Sector Telecom Operators in India is unique. The challenges are multi faceted related to Marketing, Finance, Human Resources Management etc. The Profits are under severe pressure. The Telecom Industry has contributed to the all-round growth of the Economy and there is no gainsaying the contribution of the Public Sector role. BSNL in the Telecom industry is inevitable as ''coexistence'' of both private and public is the spirit of Indian Political Economy. Hence, the continued viability of BSNL is of strategic concern for the government and industry.

Objectives of the Study

This study has the following objectives:

- To study the significance of profitability by selecting a few important parameters such as Operating Profit (EBIT), Net Profit, Return on Investment (ROI), Return on Capital Employed (ROCE), EPS, and P/E and some other crucial turnover, liquidity and capital structure ratios.
- To examine the liquidity capacity based on acid test and current ratio with certain presumptions applicable.
- To make an assessment of the critical factors which affect the profitability of BSNL.
- To give some suggestions for the betterment of the earnings on the basis of findings of the study.

Company Profile

The Company took over the business of providing telecom services and network management throughout the country except the metro cities of Delhi and Mumbai from Department of Telecom Services and Telecom Operations w.e.f. 01.10.2000 pursuant to an MoU signed between the BSNL and Government of India. BSNL is a Government Company under the Sec. 617 of the Companies Act, 1956. The entire share capital—both equity and preference—is held by the Government of India. Being GoI holding 100% equity share capital, BSNL is an unlisted company. Its Paid-up value of Equity share capital is Rs.5,000 crores and Rs. 7,500 crores preference share capital.The vision of the BSNL is to become the largest telecom service provider in South East Asia. Its Mission is to provide world class state of art technology telecom services on demand at affordable price and to provide world class telecom infrastructure to develop country's economy.

Limitations of the Study

The following are the limitations of the study:

1. The study covers only 9 years' period, i.e. 2002-03 to 2010-11, for the financial analysis of the BSNL.
2. The secondary data used in this study have been taken from published annual reports only.
3. As per the requirement and necessity some data have been grouped and sub-grouped.
4. For making analysis of financial position of BSNL, ratio analysis techniques of Financial Management.

Research Methodology and Study

In this study of sample company named BSNL has been taken for analysis of financial position in general and liquidity in specific. Present study is based on secondary data, i.e. Published annual reports of the company. These financial data is classified, tabulated and edited as per the requirement of the profitability analysis of the company. This study has covered 9 years' data from 2002-03 to 2010-11 for analysis of financial position of BSNL.

- Operating Profit Ratio
- Earning per share
- Price Earning Ratio
- Dividend Payout Ratio
- Return on Investment
- Debt-Equity Ratio
- Fixed Assets to Net Worth Ratio
- Current Assets to Net Worth Ratio
- Fixed Assets Turnover Ratio
- Working Capital Turnover Ratio
- Debtors Turnover Ratio
- Creditors Turnover Ratio
- Gross Analysis from stakeholders' point of view.

Hypothesis of the Study

This study is based on the following hypothesis:

- The earning capacity of the BSNL is similar during the study period.
- The earning capacity depends on total investment.
- Performance is measured through Profitability and turnover ratios.

Analysis of BSNL Financial Ratios for intra firm comparison from FY 2002-03 TO 2010-11.

Sl. No.	Financial Ratio / Financial Year	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	Average
1	Current Ratio	0.78	1.33	2.65	2.79	3.22	3.34	2.79	1.29	1.20	2.15
2	Liquidity Ratio	0.64	1.21	2.49	2.62	3.08	3.15	2.57	1.17	1.02	1.99
3	Net Profit Ratio %	5.58	17.62	28.22	22.25	19.65	7.91	1.61	–5.69	–21.50	8.40
4	Operating Profit Ratio %	10.27	26.52	21.95	21.02	20.53	11.70	3.55	–6.86	–22.16	9.61
5	Earnings Per share (Rs.)	2.89	11.95	18.83	15.28	14.03	4.44	1.15	–3.65	–12.77	5.79
6	P.E. Ratio (Say Price Rs.100)	34.60	8.37	5.31	6.54	7.13	22.52	86.96	–27.40	–7.83	15.13
7	Dividend Payout Ratio %	17.31	4.71	11.54	13.14	15.05	49.84	0.00	0.00	0.00	12.40
8	Return on Investment %	2.58	9.48	13.99	11.07	8.98	3.41	0.65	–2.11	–7.97	4.45
9	Debt-Equity Ratio	0.42	0.27	0.23	0.20	0.16	0.14	0.13	0.11	0.13	0.20
10	Fixed Assets to Net Worth	1.29	1.09	0.91	0.79	0.70	0.65	0.67	0.92	0.96	0.89
11	Current Assets to Net Worth	0.29	0.44	0.53	0.57	0.62	0.66	0.65	0.64	0.33	0.52
12	Fixed Assets Turnover Ratio	0.36	0.49	0.54	0.63	0.66	0.66	0.60	0.40	0.39	0.53
13	Working Capital Turnover Ratio	–5.81	5.01	2.19	1.64	1.24	1.10	1.12	4.84	–14.17	–0.32
14	Debtors Turnover Ratio	8.79	8.52	5.44	6.38	6.37	6.96	7.59	6.75	4.69	6.83
15	Creditors Turnover Ratio	1.50	2.27	2.48	2.43	2.38	2.19	1.73	0.75	1.35	1.90

Source : Annual reports of BSNL from 2002-03 to 2010-11.

The financial and liquidity position of BSNL have been analyzed by the financial techniques of Ratio Analysis.

The collected data have been analyzed with the help of the following financial ratios :

- Current Ratio
- Liquidity Ratio
- Net Profit Ratio

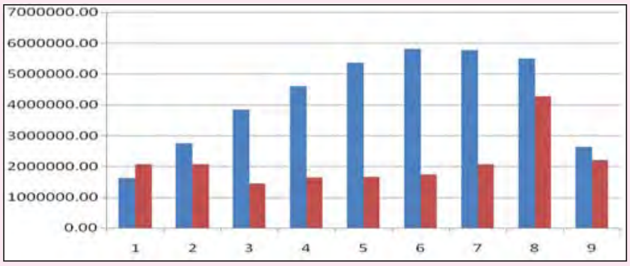
1. Current Ratio **:** It is a measure of general liquidity and is most widely used to make the analysis for short term financial position or liquidity of a firm. It is calculated by dividing the total of the current assets by total of the current liabilities.

Current ratio may be defined as the relationship between current assets and current liabilities. This ratio is also known as ''working capital ratio''. It is a measure of general liquidity and is most widely used to make the analysis for short term financial position or liquidity of a firm. It is calculated by dividing the total of the current assets by total of the current liabilities.

Current Ratio = Current Assets / Current Liabilities

Analysis of BSNL Financial Ratios for intra firm comparison from FY 2002-03 To 2010-11.											
Sl. No.	Financial Ratio / Financial Year	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	Average
1	Current Ratio	0.78	1.33	2.65	2.79	3.22	3.34	2.79	1.29	1.20	2.15

Current Asstets to Current Liabilities Bar Diagram from 2003 to 2011 (Fig. in Lakhs of Rs.)



Source : Compiled from BSNL annual Reports

Stakeholders view : Current ratio should be around 1.5 : 1, which means current assets are more than current liabilities. In case of BSNL its current ratio during the past 9 years is good and on par with industry standards. The average current ratio of BSNL is 2.15:1. BSNL has the ability to manage its current liabilities without liquidating any of its long term assets. Looking at the profitability ratios we can see that there is no immediate payments crisis developing and the company can confidently meet its short term obligations.

***2. Liquidity Ratio* :** Liquid ratio is also termed as ''Liquidity Ratio'', ''Acid Test Ratio'' or ''Quick Ratio''. It is the ratio of liquid assets to current liabilities. The true liquidity refers to the ability of a firm to pay its short term obligations as and when they become due.

The two components of liquid ratio (acid test ratio or quick ratio) are liquid assets and liquid liabilities. Liquid assets normally include cash, bank, sundry debtors, bills receivable and marketable securities or temporary investments. In other words, they are current assets minus inventories (stock). Inventories cannot be termed as liquid assets because it cannot be converted into cash immediately without a loss of value.

Liquid Ratio = (Curent Assettes-Inventories) / Curent Liabilities

Stakeholders' view : General ideal ratio of liquidity is 1 : 1, in this regard high liquidity during the past. In the year 2010-11 the ratio is 1.02 : 1 which is considered to be ideal ratio of liquidity. However, the average liquidity of the BSNL during the past is 1.99 : 1 which is considered higher liquidity in the industry. Over the years the company has built up a strong ethics of liquidity and its highly liquid components of current assets have been more than the illiquid items. This gives confidence to both the insiders who deal with the company on day-to-day basis and the vendors and suppliers.

***3. Net Profit Ratio* :** Net profit ratio is the ratio of net profit (after taxes) to sales. It is expressed as percentage. The two basic components of the net profit ratio are the net profit and sales. The net profits are obtained after deducting income-tax.

Net Profit ratio is used to measure the overall profitability and hence it is very useful to proprietors. The ratio is very useful as if the net profit is not sufficient, the firm shall not be able to achieve a satisfactory return on its investment.

This ratio also indicates the firm's capacity to face adverse economic conditions such as price competition, low demand, etc. Obviously, higher the ratio the better is the profitability. But while interpreting the ratio it should be kept in mind that the performance of profits also be seen in relation to investments or capital of the firm and not only in relation to sales.

***Stakeholders view* :** BSNL is having growth in profitability up to 2004-05 (i.e. 28.22%) and started declining from 2005-06 and reached to negative level by 2010-11. Decline in the total revenue figure over the past led to negative Profit after tax. Revenue fall is due to various reasons like fall of voice call charges to near Zero level, unrestricted entry in to the telecom sector in India, falling landline connections, lack of marketing skills to render service to the customers. The average Net Profit of BSNL is 8.4%. The profit position has been strongly maintained over the years despite disruptive market forces. It is only during the last two years that it has declined somewhat. It can be seen that the Net worth of the company has not been affected substantially due to this, and the long terms average is good.

4. Operating Profit Ratio : Operating Profit Ratio shows the percentage of profit earned on every rupee of revenue earned.

Operating Ratio is calculated as: PBIT/Total Revenue * 100

Analysis of BSNL Financial Ratios for intra firm comparison from FY 2002-03 To 2010-11.											
Sl. No.	Financial Ratio / Financial Year	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	Average
2	Liquidity Ratio	0.64	1.21	2.49	2.62	3.08	3.15	2.57	1.17	1.02	1.99
3	Net Profit Ratio%	5.58	17.62	28.22	22.25	19.65	7.91	1.61	–5.69	–21.50	8.40
4	Operating Profit Ratio %	10.27	26.52	21.95	21.02	20.53	11.70	3.55	–6.86	–22.16	9.61

Operating costs as a percentage of Revenues 2003-2011

Source : Compiled from BSNL Annual Reports

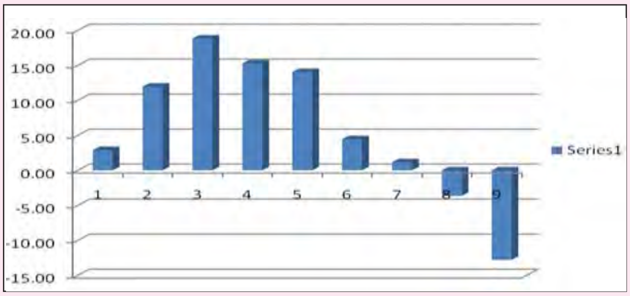
Stakeholders' view : The relationship between the Profits before Interest, taxes to Total Revenue. During the past 9 years' period the average operating profit is 9.61%. The Operating sales shows gradual increase from 2002-03 to 2005-06 and gradual decrease there from. During the study period the mean deviation with respect to Operating sales is even. The Operating profit ratio is volatile in most of the years. The high growth years were due to the introduction of mobile services and consumer euphoria that followed. BSNL has been unable to maintain this trajectory because of capacity constraints in the emerging segment. But this appears to be temporary as the Telecom sector itself is fast changing from ''voice to data and beyond'', where the company with its considerable muscle power in long distance backhaul network infrastructure can foray into Broadband services.

5. Earning Per Share : Earnings per share is generally considered to be the single most important variable in determining a share's price. It is also a major component used to calculate the price-to-earnings valuation ratio. An important aspect of EPS that's often ignored is the capital that is required to generate the earnings (net income) in the calculation. Two companies could generate the same EPS number, but one could do so with less equity (investment)—that company would be more efficient at using its capital to generate income and, all other things being equal, would be a ''better'' company. Investors also need to be aware of earnings manipulation that will affect the quality of the earnings number. It is important not to rely on any one financial measure, but to use it in conjunction with statement analysis and other measures.

Formula for calculating EPS = Profits available to Equity Shareholders/No.of Equity Shares. BSNL is having its paid up capital of Rs. 5,000 crore divided in 500 crore equity shares of Rs. 10/- each.

Earnings Per share for BSNL 2003-2011

(Figures in whole rupees.)



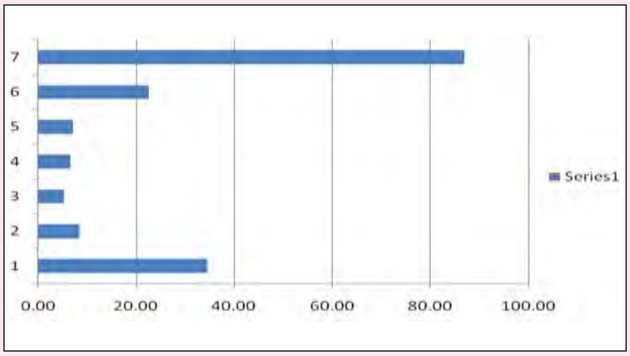
Source : BSNL Annual Reports

Stakeholders' view : The average Earnings per share in BSNL is Rs. 5.79 during the past 9 years which means the owners are earning not less than 50% of their investment in equity during all the years so far. This indicates its potential so far and future is to be designed accordingly. Governments returns on investment in telecom consists not only of the actual financial but also the social and developmental linkages that it involves. Considered in this perspective the long term returns are good. However, with impeding wave of reforms in this sector the shortfalls during the last two years might be a temporary dip.

6. Price Earning Ratio : Price earnings ratio (P/E ratio) is the ratio between market price per equity share and earning per share. The ratio is calculated to make an estimate of appreciation in the value of a share of a company and is widely used by investors to decide whether or not to buy shares in a particular company. It helps the investor in deciding whether to buy or not to buy the shares of a particular company at a particular market price. Generally, higher the price earning ratio the better it is. If the P/E ratio falls, the management should look into the causes that have resulted into the fall of this ratio.

Price Earnings Ratio = Market price per equity share/Earnings per share

Price-Earnings Ratio of BSNL from 2003-2009



Source : compiled from BSNL Annual Reports

Stakeholders' view : In case of BSNL as it is not listed company the market price per share is assumed as Rs. 100/- per every equity share of Rs.10/- each. The average price earning ratio of BSNL is Rs.15.33. It means that to earn a rupee, 15.33 rupees need to be invested. Normally it is considered high side by the potential investors. The authors feel that an issue ESOP to the employees at par at this juncture may be successful.

7. Dividend Pay-out Ratio : Dividend pay-out ratio is calculated to find the extent to which earnings per share have been used for paying dividend and to know what portion of earnings has been retained in the business. It is an important ratio because ploughing back of profits enables a company to grow and pay more dividends in future.

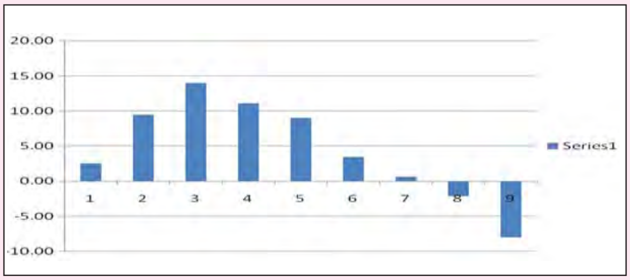
Dividend Payout Ratio = Dividend per Equity Share/Earnings per Share

Stakeholders' view : Dividend payout ratio in the initial years is high where the earnings of the company is good. Since 2008-09 its profits reached Zero level and no dividend is paid till 2010-11. Unless the company gets profits in the future the point of payment of dividend may not arise. The average dividend pay out ratio of BSNL is Rs. 12.40. Retained Earnings are very high percentage of nearly 88% for BSNL, which augurs well for the future of the company.

8. Return on investment : It is the ratio of net profit to shareholder's investment. It is the relationship between net profit (after interest and tax) and share holder's/proprietor's fund.This ratio establishes the profitability from the shareholders' point of view. The ratio is generally calculated in percentage.

Return on shareholder's investment = Profit after Tax /Equity. Share holder's fund $\times$ 100

Return on Investments in BSNL 2003-2011 (Fig. in Percentage)



Source : calculated from Annual Reports

Stakeholders' view : The return on investment is highest in the year 2004-05. The return figure is positive up to 2008-09 later it becomes negative. The average return on investment is 4.45% which is less than the average inflation rate of Indian economy during the period of study. Here again this ratio might not be adequate to represent the expected returns from investments in a public sector company. Social economic factors also need to be given due weight age.

Analysis of BSNL Financial Ratios for intra firm comparison from FY 2002-03 To 2010-11.

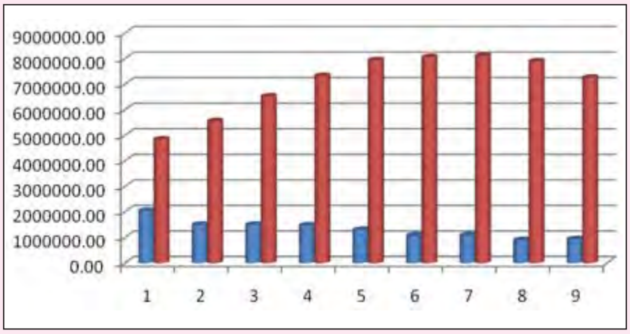
Sl. No.	Financial Ratio/Financial Year	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	Average
5	Earnings Per share (Rs.)	2.89	11.95	18.83	15.28	14.03	4.44	1.15	–3.65	–12.77	5.79
6	P.E. Ratio (Say Price s. 100)	10.27	26.52	21.95	21.02	20.53	11.70	3.55	–6.86	–22.16	9.61
7	Dividend Payout Ratio %	17.31	4.71	11.54	13.14	15.05	49.84	0.00	0.00	0.00	12.40
8	Return on Investment%	2.58	9.48	13.99	11.07	8.98	3.41	0.65	–2.11	–7.97	4.45

9. Debt-Equity Ratio : Debt-to-Equity ratio indicates the relationship between the external equities or outsiders funds and the internal equities or shareholders funds. It is also known as external internal equity ratio. It is determined to ascertain soundness of the long term financial policies of the company.

Debt to Equity Ratio = Total Long Term Debts / Total Long Term Funds

9. Debt-Equity Ratio: BSNL 2003-2011

Proportion of External Debts to Equity Shareholders Funds in BSNL for 2003-2011 (Fig. in lakhs. of Rs.)



Source : calculated from Annual Reports

Stakeholders' view : Debt to equity ratio indicates the proportionate claims of owners and the outsiders against the firm's assets. The purpose is to get an idea of the cushion available to outsiders on the liquidation of the firm. However, the interpretation of the ratio depends upon the financial and business policy of the company. The owners want to do the business with maximum of outsider's funds in order to take lesser risk of their investment and to increase their earnings (per share) by paying a lower fixed rate of interest to outsiders. The outsiders (creditors) on the other hand, want that shareholders (owners) should invest and risk their share of proportionate investments. A ratio of 1:1 is usually considered to be satisfactory ratio although there cannot be rule of thumb or standard norm for all types of businesses. Theoretically, if the owner's interests are greater than that of creditors, the financial position is highly solvent. In analysis of the long-term financial position it enjoys the same importance as the current ratio in the analysis of the short-term financial position.

In this regard BSNL is having very good ratio as its debts to equity on an average is 0.2:1. This appears to be a good financial management by the company because of the volatility in the early years of competition and entry of private players into the market. A high borrowing level would have been difficult to service due to the uncertainty in the returns.

10. Fixed Assets to Net Worth : Fixed assets to net worth ratio establishes the relationship between fixed assets and shareholders funds. The purpose of this ratio is to indicate the percentage of the owner's funds invested in fixed assets.

Stakeholders' view : The ratio of fixed assets to net worth indicates the extent to which shareholder's funds are sunk into the fixed assets. Generally, the purchase of fixed assets should be financed by shareholder's equity including reserves, surpluses and retained earnings. If the ratio is less than 1, it implies that owner's funds are more than fixed assets and a part of the working capital is provided by the shareholders. When the ratio is more than the 1, it implies that owner's funds are not sufficient to finance the fixed assets and the firm has to depend upon outsiders to finance the fixed assets. On an average, BSNL is financing its fixed assets out of its own funds as the ratio is 0.89 and the balance of own funds to the tune of 0.11 are used for working capital also. Hence, the stakeholders in this regard appreciate the composition of financing the assets.

This is a happy situation from the employee point of view, because the real assets created by the company purely out of internal accruals and surpluses, will bring in considerable appreciation in the market value of these assets. Thereby the company will be in a good position to tide over any extreme, though unlikely, situation at a future date.

11.Current Assets to Net Worth : Current assets to net worth ratio establishes the relationship between Current assets and shareholders funds. The purpose of this ratio is to indicate the percentage of the owner's funds invested in Current assets.

Stakeholders view : In this regard BSNL is having its current assets as 52% of its Net worth. Hence the stakeholder is perhaps happy with the optimum composition of existing net worth.

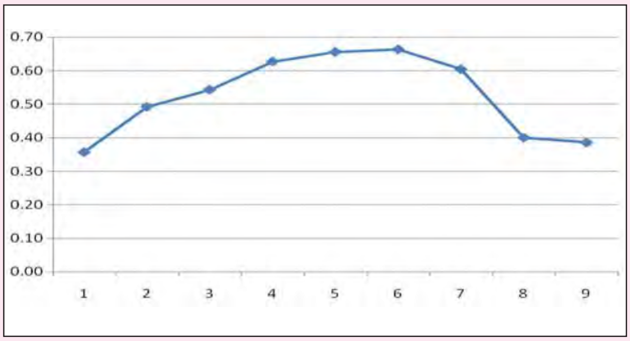
Analysis of BSNL Financial Ratios for intra firm comparison from FY 2002-03 To 2010-11.

Sl. No.	Financial Ratio / Financial Year	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	Average
9	Debt-equity Ratio	0.42	0.27	0.23	0.20	0.16	0.14	0.13	0.11	0.13	0.20
10	Fixed Assets to Net Worth	1.29	1.09	0.91	0.79	0.70	0.65	0.67	0.92	0.96	0.89
11	Current assets to Net worth	0.29	0.44	0.53	0.57	0.62	0.66	0.65	0.65	0.33	0.52

12. Fixed Assets Turnover Ratio : Fixed assets turnover ratio is also known as sales to fixed assets ratio. This ratio measures the efficiency and profit earning capacity of the concern. Higher the ratio, greater is the intensive utilization of fixed assets. Lower ratio means under-utilization of fixed assets. The ratio is calculated by using following formula :

Fixed Assets Turnover Ratio = Total Revenue / Total Fixed Assets

Fixed Assets Turnover Ratio BSNL 2003-2011



Source : calculated from Annual Reports

Stakeholders' view : The average Fixed Assets turnover ratio in BSNL is just 0.53 which means the assets are not used even to the value of 1 time. The under-utilization of fixed assets is clear. The management should find ways and means to use the existing asset base to its fullest value.

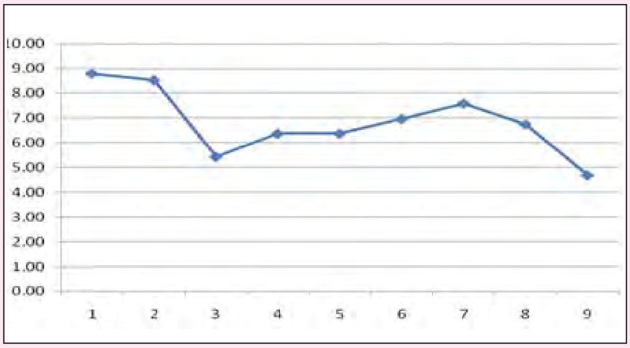
13. Working Capital Turnover Ratio : Working capital turnover ratio indicates the velocity of the utilization of net working capital. This ratio represents the number of times the working capital is turned over in the course of year and is calculated as :

Working Capital Turnover Ratio = Cost of Sales / Net Working Capital

Stakeholders view : This ratio is volatile with respect to BSNL is concerned 2003-04 and 2009-10 it is having optimum ratio i.e. 5.01 and 4.84 times, respectively.

14. Debtors' Turnover Ratio : Debtors' turnover ratio or accounts receivable turnover ratio indicates the velocity of debt collection of a firm. In simple words, it indicates the number of times average debtors (receivable) are turned over during a year.

Debtors' Turnover Ratio (BSNL 2003-2011)



Source : calculated from Annual Reports

Stakeholders' view : As per the table above the average is 6.83 times (say 7) in a financial year which is considered good for a company with annual turnover ranging from 30,000 crore to 40,000 crore.

15. Creditors Turnover Ratio : This ratio is similar to the debtors' turnover ratio. It compares creditors with the total credit purchases. It signifies the credit period enjoyed by the firm in paying creditors. Accounts payable include both sundry creditors and bills payable. Same as debtors' turnover ratio, creditors' turnover ratio can be calculated in two forms, creditors' turnover ratio and average payment period.

Creditors' Turnover Ratio = Credit Purchase / Average Trade Creditors

Stakeholders' view : The average payment period ratio represents the number of days by the firm to pay its creditors. A high creditors' turnover ratio or a lower credit period ratio signifies that the creditors are being paid promptly. This situation enhances the credit- worthiness of the company. However, a very favorable ratio to this effect also shows that the business is not taking the full advantage of credit facilities allowed by the creditors. When compared to the Debtors' Turnover Ratio, Creditors' Turnover Ratio is 3 times lower which can be positive side of working capital management in BSNL.

Analysis of BSNL Financial Ratios for intra firm comparison from FY 2002-03 To 2010-11.

Sl. No.	Financial Ratio / Financial Year	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	Average
12	Fixed Assets Turnover Ratio	0.36	0.49	0.54	0.63	0.66	0.68	0.60	0.40	0.39	0.53
13	Working Capital Turnover Ratio	–5.81	5.01	2.19	1.64	1.24	1.10	1.12	4.84	–14.17	–0.32
14	Debtors' Turnover Ratio	8.79	8.52	5.44	6.38	6.37	6.96	7.59	6.75	4.69	6.83

(contd. to page 568)

Organization Development : An Orientation to Change Management

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Organization development is a systematic, long-term effort and planned approach that improves organization's operation by using effective and collaborative diagnosis, culture and behavioral science techniques; it also contributes to the significant change in the attitude and behaviour of personnel through self-analysis plan. The theory of organization development elucidates as an application of behavioural science to organizational changes. It consists of a wide-range theories, process, and activities, all of which are designed towards improving the organization's effectiveness. It is a general practice that organization undergo pertinent changes in their development process, as it decides to change its complete strategy or the ideology by which organization do perform and some modification in prudent practice are needed. In today's highly turbulent business environment, change has assumed an inevitable part of life. Organizations that do not attach importance to the need for change do not survive long. Organizations must change so that they may remain competitive in today's globalization's market place. **Kanter** points out 'that organizations which either fail to understand the need for change or are inept in their ability to deal with change will fade and fall behind, if they survive at all'.

The field of organization development has occupied a vital place for improving the effectiveness of organizations and the people involved in these organizations. Organization development has a rich background of research and practice regarding change in organizations Organization development, as one of the most effective tools of change, is used by business house to modify the culture, value and structures of an organization that enables organization to face to new markets, technologies and other business challenges with the development and improvement of organizational processes. So there is acute need for organization development in Indian set-up. Effective strategic and operational plans, team and leadership development and competitive products or services may come out as a result of a successful organization process. **Peter Drucker** has rightly said 'the entrepreneur always searches for changes, respond to it, and exploit it as an opportunity.' The term organization development is often used interchangeably with organization design, learning and development and organizational effectiveness and business processes re-engineering and large group interventions are newer developments in this field. A striking feature of organization development process is the change agent, which is mostly carried-out by the outside consultants, who have a different perspective and a biased free thought as regards to organizational feedback. The organization development plan can be seen in **Exhibit-1.**

There are variations regarding the definition of organization development. **Richard Beckhard** has described organizational development as an effort (1) planned, (2) organization-wide, and (3) managed from the top, to (4) increase organization effectiveness and health through (5) planned interventions in the organization's 'processes', using behavioral science knowledge. This stresses the concept of application and transfer of behavioural science knowledge and practice, thereby paying more attention to sensitive issues like leadership, group dynamics and work design. **Neilsen** alludes that 'organization development is an attempt to motivate the staff members to resume greater responsibility for their work'. The rationale behind organization development is that people are encouraged to findout new ways for achieving their own objectives as well as organizational goals. The field of organization development is related to the field of medicine, as organizations are made up of humans. Organization theory and organization behaviour is similar to the field of anatomy, physiology of human system and psychology and sociology of human system, respectively.

The level of effectiveness is totally related to organization's ability to commensurate itself to fast-growing rapid changes in the sphere of environment and technology. **Warner Burke** points out that organization development is the changes that will 'more fully integrate individual needs with organizational goals; leads to greater organization effectiveness through better utilization of resources, especially human resources; and provide more involvement of organization members in the decision that directly affect them and their working conditions.' **Machael Beer** defines organization development as 'a system-wide process of data collection, diagnosis, action, planning, intervention and evaluation aimed at (1) enhancing congruence among organizational structures, process, strategy, people and culture; (2) developing new and creative organizational solutions; (3) developing the organizational self-renewing capacity.

Exhibit 1

Organizational Development Plan

Organizational Development Process

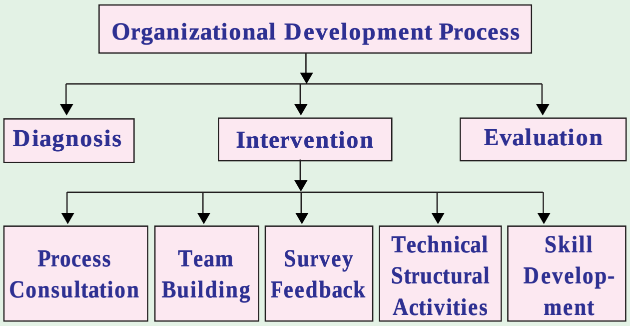
The Measurement Phase

Preferred Operating Culture This defines what management wants to achieve in way of behavioural science	**Causal Factors** These are antecedents of culture. They are what members look to in order to determine the unwritten rules	**Actual Operating Culture** These are the behaviour norms operating through the organization
Recycle To assess impact of change initiatives and review strategies and actions	**The Levers for Change** Changing structures, system, technologies and leadership skills to influence behavioural norms	**Culture Change Targets** Execute what behavioural norms need to be targeted to lead more positive results

(Source: Human Synergistic (NZ) Ltd. 2010)

There is a general belief among the top management that the process of organization development is initiated on the event of finding discrepancy in the organization, which can be classified into three stages : diagnosis, intervention and evaluation—as shown in **Exhibit 2**.This process entails on the basic fact as establishing relationship with key personnel, evaluating systems in the unit, identify approaches, apply approaches and more over evaluating the results.

Exhibit 2



Organization Development Plans

There are numerous accepted models for ensuring the success of a change effort. Some of the approaches have been used by business organizations in regular course, but we have not considered them as such. The use of strategic planning is general phenomena, but when it is implemented in a systematic and explicit manner, it becomes one approach for a change effort. Planned interventions related to the organization's processes may enhance organization's effectiveness— which is the crucial objective of organization development. Organization development interventions are strategic plans comprised of specific activities designed to effect change that is made by an organization. The study of organization development advocates a number of methods—variety of processes, approaches, techniques and application defined as 'interventions', training, action research, survey feedback, human resource developments are few examples of organization development interventions used by Indian organizations.

Training and Organization Development

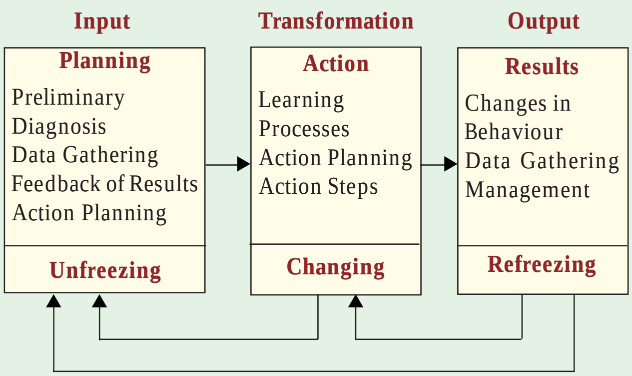
Generally, a very simple question is raised 'What does it have to do with training'. The overall process of organization comprises three areas of a unit: people, process and planning. While training handles only people component. Training personnel cannot solve every issue. As **Stephen Wehrenberg** elaborates in his personal journal article titled "The Vicious Circle of Training and Organizational Development "that as trainers become more experienced, they begin to see that many of their organizational' problems cannot be resolved simply by training. Trainers see problems as part of a total system—problems such as poor communication, poor quality control, and low productivity'. But, at present, training is assumed as a concrete vehicle for evolving dynamic channel of interaction between different participants within the organization. It raises the conscious to articulate deficiencies and also creates new ideas for change which gives greater enthusiasm for change. That is why training can be assigned to be effective organization development intervention. A large number of business organizations basically use training in a planned way to make changes. Training in key performance areas contributes to a medium of participation and involvement and also provides an opportunity for greater learning and knowledge of organizational problems.

Action Research and Interventions

Apparently, organization development emphasizes on two activities—action research and interventions. The theory of action research was developed by **Kurt Lewin** and **John Collier** in the 1940s as 'a process of systematic collecting the data, feeding it back for action, planning and evaluating results and interpreting the same'. It conceptualized 'rational social management 'comprised of plan, action and results of action. Action research is a data based problem solving model that requires the steps which are requisite in the scientific method of inquiry.' **W L French** identified a standard action research plan which devises the procedure as identification of key issue, consultation with change personnel, and collection of data, facilitate feedback to the executives, determining change objectives and developing the change plan based on research and implement the plan for change effort.

As the change agent intervenes in the organization to effect change, action research becomes the intervention component and assumed a facet of action research. There are many interventions addressed to transform behaviour and attitude of the staff in a unit. An action or experiential exercise which is related to organization improvement plan in a change process can be identified as interventions. **Lewin** has mentioned three steps in change process as unfreezing, changing and refreezing—as shown in **Exhibit 3.** These three steps are associated with identification of dilemma, development of new models of behavior, and evaluation of applied model or behaviour, respectively.

Exhibit 3 System Model of Action Research Process



Organization Development and Human Resource

Organization development is not a new field and has always placed more emphasis on people; therefore it has become recently an important constituent of human resource. It is distinct from human resource development in the sense that while process of human resource development is concerned with the development and training of people in the organization, organization development is entrusted with the task of development and improvement of organization process. Organization development does not replace human resource but it is based on vital processes of human resource function. There is pre-requisite that effective organization development should also have the whole-hearted support and involvement of senior staff members of the organization for the purpose of implementation of organization development interventions. Though, the theory of organization development is based on social science and applied behaviour, on the contrary, human capital theory, performance model are part of human resource, but the literature on the record substantiate the fact that these two fields are collaborating and integrating together.

In 1988, professionals **Jelinek and Litterer** highlighted the broadened area of organization development in the form of team building, group decision, building organizational learnings and skills which human resource professionals can utilizein strategic approach of organization development as a well planed and long-range approach**. Cummings** and **Worley** (researchers) also found the fact that goal determination based on performance management reward system, career planning and workforce diversification are direct outcome of organization development practices. In fact, in the coming years, the use of human resource professional will emerge critically in relation to organizational change for adopting organization development effectively.

To conclude, **DeKlerk** (2007) describes that emotional ordeal experience, aggression, anxiety, apprehension emerged due to downsizing, mergers, restructuring and outsourcing, can lead to the deterioration in the production. In India, after trained at National Training Laboratory at USA, some professionals started this technology early in 1960s. First, L & T introduced organization development as a formal and structured plan in middle 1970s. Organization development could not get desired success in India, as Indian corporate sector—with its secured and protected philosophy—was hesitant to initiate changes in prudent practice, but it registered its presence in academic arena. In post-liberalization era, there was stimulus to the use of organization development technique. Indian Society for Applied Behaviour Sciences, Indian Society for Individuals and Social Development, Indian Society for Training and Development and, moreover, academic institutions like IIMs can play a vital role towards greater use of this technology. There is an imperative need to develop awareness and knowledge regarding the 'change processes' within the organization, which is coordinated by usually external consultants along with active participation of all stakeholders. In recent times, the relevance of organization development to incorporating changes in modern organization has become questionable. The need for reinventing this field is an emerging issue with the sense of deep understanding of human and organization process. ❐

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Conclusion

A study like this—though it cannot fully espouse the Employees' point of view as it is based only on accounting figures—throws sufficient light to conclude that the Financial strength which BSNL has built up over the years will stand in good stead during the period of transition which it is facing presently. The present situation is more due to the impact of external environmental forces of the sector as a whole and not fully its own making. The stakeholders, as defined at the beginning of this paper, have reason to believe that the company is on sound footing as far as key parameters of performance is measured and grouped. However, the continued profitability and ability to accumulate surpluses will depend on the direction which the company takes—particularly with regard to cost control measures, elimination of wasteful operating expenses and the strategy changes in product mix. A deliberate movement towards innovative projects that successfully deliver value to today's subscribers—especially applications related to Data and E-commerce etc.—will be necessary. Productivity of Capital as measured by return on assets depends on the attitude and culture of the organization. Employees as stakeholders need to appreciate that—in a highly technical and capital intensive industry like Telecom—current performance parameters are a pointer to this basic input that ultimately determines their aspirations as a Stakeholder Group. ❐

An empirical study of relationships between relational psychological contract and employees' attitudes towards OCB factors and its application in Indian Industry



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Introduction

The growth of the Indian economy is happening at the rate of 6 to 8% successively for the past few years. In today's competitive world it is imperative for the organizations to build employee commitment for higher growth. Motivation influences the talent to drive the organization's growth (Rousseau, D. M. 1990). The employees have also found to display certain behaviours by going beyond the normal requirements of the role / task performance. These behaviours are named as organizational citizenship behaviours (OCB) and have been found to be also contributing to the organizational growth (Organ 1988). The comprehensive definitions for the OCB factors (dependent variable) are :

1. Altruism (AL) : Discretionary behaviours on part of the employees to help, guide or assist fellow colleagues or take responsibilities for them.

2. Conscientiousness (CO) : Discretionary behaviours on part of the employee to take ownership of his work and related self-development, set challenging targets and meeting deadlines, taking decisions based on self-conscience and observant of the rules and values of the organization.

3. Sportsmanship (SM) : Discretionary behaviours on part of the employee to drive oneself to surpass others' performance, appreciate others and contribute so that fellow colleagues meet their objectives and push them to excel, accepts own mistakes and express emotions appropriately, be tolerant to organizational negativities and accept the organizational changes.

4. Courtesy (CT) : Discretionary behaviours on part of the employee to initiate resolution of issues, build consensus and actively contribute to conflict resolutions, locating resources / experts for organizational problems, collaborating with others, being aware of the impact of self behaviours on other people and their work.

5. Civic Virtue (CV) : Discretionary behaviours on part of the employee to participate actively into the organizational affairs and be informed about the organizational developments, defend its reputation, be vigilant about organizational policies and report any violations, take up fellow colleagues' grievances.

In the late eighties and early nineties, Dr. D. M. Rousseau in USA and Dr. David Guest in U.K. conducted research on employee-employer relationships that have a bearing on employee involvement in the organizations. They conceptualized employee-employer relationship much different from the legal contractual nature. Dr. D. M. Rousseau (1990) has defined Psychological contracts (PC) as are beliefs based on promises implied or expressed regarding an exchange agreement between the employee and the organization. They are voluntary in nature and believe in mutual agreements. At a given time they are incomplete and there are multiple contract makers. They focus on fulfilling commitments and provide a model for employment relationship. The contract is based on employees' sense of fairness, trust and belief that commitments are being honoured by the employer. Morrison and Robinson (1997) have defined Psychological contract as individual perceptions created by organizations about what will be exchanged for each others contributions. To have a psychological contract, a relationship between individual and organization must exist and individuals must have expectations about what he will get from the organization. When employers meet perceived obligations of psychological contract, employees are motivated, willing apply greater effort, seek out creative solutions, support their leaders and remain with the organization (Rousseau 1990, Sims 1994, Spindler 1994). When the obligations are unfulfilled, employees lose trust in management, reduce their levels of organization commitments and decrease their contributions (Levinson, Price, Munden, Mandl, Solley 1963; Robinson & Rousseau 1994; Sapienza, Korrsgaard, Shneiger 1997). Further research on relationships of the employees and organizations developed the concept of relational psychological contract (relational PC).

It indicates that the employee is obligated to remain in employment with the organization and do what is required to keep the job going. The employer also fulfills its obligation by providing stable remuneration, long-term job security and steady career growth. Employee is obligated to be loyal to the organization and support the objectives, needs and interests of the organization. The employee should be a dedicated and a loyal corporate citizen. The employer fulfills its part of obligation by ensuring the well-being of the employee and their families.

As OCB and relational PC were emerging as topics for contemporary research in behaviour science, the researcher felt that it would be significant to examine whether there was any linkage between the OCB and employees' beliefs regarding their obligations towards the organization as indicated by EE factor—relational PC. They are :

EE Stability

EE stability states that employee is obligated to remain with the organization and plan a long-term growth. He has to at least contribute as per the basic performance expectations to retain his job. He has to strive to do improvements in a way his job has to be done.

EE Loyalty

EE loyalty refers to the obligation of the employee to support the organization and serve to its needs and interests. He would demonstrate his commitment by protecting organization's image, taking organization's concerns personally and making personal sacrifices for the organization, if need be.

Responses of 540 employees from executives and management cadre from Indian corporate sector was collected through a detailed questionnaire (Cronbach alpha =0.7, an acceptable reliability coefficient, (Nunnaly (1978) and Streiner D. L. (1989). They were from manufacturing (engineering, textiles and steel forgings), services (BPO, IT, telecom, financial services) and infrastructure (power, transportation, oil & gas). Statistics related to testing significance of differences (ANOVA ONE WAY) were used for analysis.

The findings on the relationship of OCB with each of the EE - relational PC factor are :

1.1. EE stability

Statistical analysis

Table 1.1.1. EE Stability & OCB factors (mean & standard deviation)

EE stability	AL	CO	SM	CT	CV
Group 1 : High scores (n = 94)	16.851 (2.3324)	17.330 (2.3019)	17.202 (2.3627)	16.436 (2.4824)	17.840 (2.0016)
Group 2 : Moderate scores (n = 369)	15.875 (2.3913)	16.528 (2.1149)	16.220 (2.2258)	15.623 (2.3652)	16.580 (2.3498)
Group 3 : Low scores (n = 77)	14.922 (2.5842)	15.935 (2.7064)	15.818 (2.1808)	14.455 (2.6185)	15.208 (2.7064)

Figure 1.1.1 EE Stability & OCB factors (means)

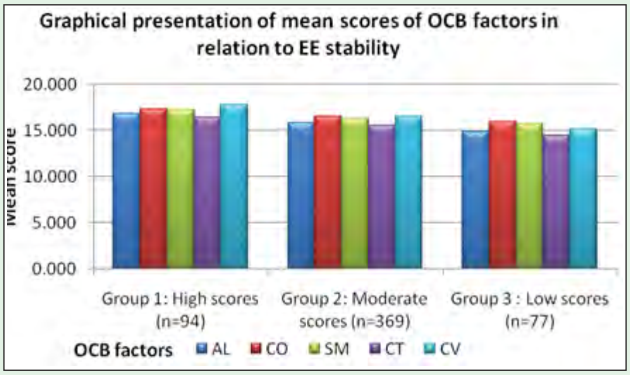

Table 1.1.2. Anova to compare EE stability and OCB factors

OCB Factor	DF (between group)	DF (within group)	MSS (between group)	MSS (within group)	F value	Pr > F
AL	2	537	79.4204	5.8058	13.68	<.0001
CO	2	537	42.9234	5.0194	8.55	0.0002
SM	2	537	48.0832	5.0351	9.55	<.0001
CT	2	537	83.4753	5.8712	14.22	<.0001
CV	2	537	147.0096	5.5143	26.66	<.0001

Conclusion

Since p values < 0.05, at 5% level of significance we conclude that there are significant differences in preference for OCB factors (altruism, conscientiousness, sportsmanship, courtesy, and civic virtue) w.r.t. preference for EE stability.

Interpretations : The employee group with a high EE stability belief has high preferences for all OCB factors. The highest preference is for civic virtue, followed by conscientiousness and sportsmanship. The same preferences are repeated for the group with perceived moderate EE stability. The employees with a high / moderate EE stability feel that they are obliged to have a long term career with the organization and plan a long term growth. Hence these employees are interested in the developments regarding organization and very active in organizational affairs. They have their future entwined with the organization. They feel that they have an obligation to the organization to put in the desired performance levels and, hence, strive to take on stretched targets, take advantage of the development opportunities provided by the organization. They are very loyal to the organization, observe its rules and regulations and take decisions based on their conscience. As these employees are together in the organization on the long term basis, they have a good bonding between them. Hence there is a healthy competition between the peers to exceed performance targets and also tendency to support others so that they meet the objectives. As these employees are committed to the organization, they tolerate organizational negativities, welcome change for the betterment.

The employees, who have a perceived EE stability in the organization, have least preference for courtesy, followed by altruism and civic virtue. These employees do not have any long term career plans with the organization. Hence collaborating with others to resolve organizational problems and conflicts may not be very high on their agenda. They may not be aware of the impact of their behaviours on work / others. These employees could be focused on building their curriculum vite and may not have any reasonable level of bonding with fellow colleagues, to offer help, guide or assist and be responsible for them. These employees also may like to leave the organization as they do not feel like having a long career with it. Their objective would be to search for a job in the other organization which would be more in line with their expectations. Therefore they may not like to expend their energies in organizational affairs.

1.2. EE loyalty

Statistical Analysis

Table 1.2.1. EE loyalty & OCB factors (mean & standard deviation)

EE stability	AL	CO	SM	CT	CV
Group 1 : High scores (n = 90)	16.889 (2,5679)	17.022 (2,4263)	17.156 (2,1976)	16.578 (2,5746)	17.911 (2,1021)
Group 2 : Moderate scores (n = 372)	15.952 (2.2874)	16.734 (2,0484)	16.433 (2,1427)	15.651 (2,3279)	16.648 (2,2937)
Group 3 : Low scores (n = 78)	14.577 (2.6064)	15,359 (2,6919)	14,910 (2,4023)	14,218 (2,5053)	14,885 (2,6530)

Figure 1.2.1. EE loyalty & OCB factors (means)

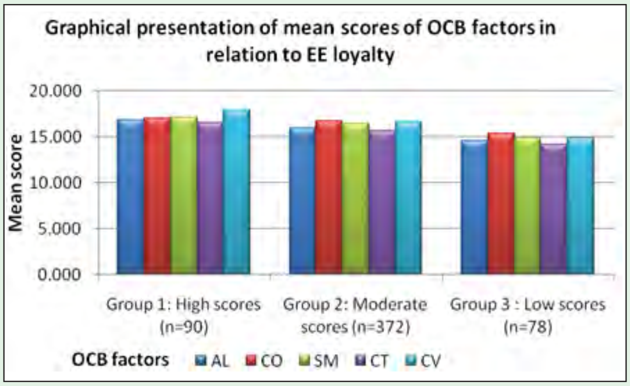

Table 1.1.2. Anova to compare EE loyalty and OCB factors

OCB Factor	DF (between group)	DF (within group)	MSS (between group)	MSS (within group)	F value	Pr > F
AL	2	537	112,7487	5.6817	19.84	<.0001
CO	2	537	71.3463	4.9135	14.52	<.0001
SM	2	537	111.2430	4,7998	23.18	<.0001
CT	2	537	117.9889	5,7427	20.55	<.0001
CV	2	537	192.5369	5.3447	36.02	<.0001

Conclusion

Since p value < 0.05, at 5% level of significance we conclude that there are significant differences in preference for OCB factors (altruism, conscientiousness, sportsmanship, courtesy, and civic virtue) w.r.t. preference for EE loyalty.

Interpretation : The employees who believe in high organizational loyalty demonstrate their commitment to the organization, show high preferences for all the OCB factors. The highest preference is for civic virtue followed by sportsmanship and conscientiousness. The employees may have a strong belief that they need to very loyal to the organization as they are committed to it, would be interested in keeping informed about the developments relating to the organization—on business front or otherwise. They would like to actively participate in the organizational matters and may see this as a re-enforcement of their loyalty. These employees are concerned about protecting organization's image and defend the same if need be. The loyal employees to the organization would also strong bond with other employees who are being perceived as loyalists. These employees may enjoy a special relationship with each other—"the old boy" network. They would have a healthy competition between each other to move ahead with their objectives. They would extend support to others to ensure that these people are also managed to achieve the desired performance. They urge the other loyal subjects to put in their best contributions. The loyalists have a very strong commitment to the organization and there is an impression that if the organization has to succeed then everyone in the organization need to make sincere efforts to attain the desired performance. The loyalists would welcome change in the organization, as they are committed to the organization. Hence the preference for conscientiousness is very closely following civic virtue and sportsmanship. The desire to take on steep targets, take control of one's development, decision making based on self-conscience for organization's betterment and obligation to the rules / processes of the organization once again demonstrate the commitment and support of these employees to the organization.

The employees with the belief of moderate organizational loyalty as an indicator to their commitment to the organization show highest preference to conscientiousness, followed by civic virtue and sportsmanship. Their preference for conscientiousness may indicate that they feel performance is one important indicator of their commitment to the organization. These employees would strive to perform better by voluntarily accepting higher targets and upgrading their skills on a continuous basis. They would be committed to organizational values and always have organization's best interest in mind. However, due to these employees' belief in organizational loyalty in a moderate manner, they may not have a very high desire to be alert about organizational developments and an urge to participate in the organizational affairs in a very active manner and to make personal sacrifices for the organization. These employees could be clearly focused on delivering what the organization desires through their high performance and thus justify their existence within the organization. Therefore they may not pay high attention to support and push other members of the organization to achieve the desired performance levels. They would tolerate negativities of the organization to an extent and may support change if convinced about it. The strong focus on individual performance may give rise to some professional rivalry amongst these employees. Hence the lower preference to sportsmanship compared to conscientiousness.

The employees with a low perception of EE loyalty in their organization have indicated the lowest preference to courtesy followed by altruism. As the commitment levels of these employees to the organization are very low, they may not be bothered to resolve organizational issues and conflicts by coming together and collaborating. As the desire for teamwork is low, these employees would not be bothered about impact of their behaviour / work on other colleagues in the organization and the downward pull that may create on organization's performance. At this stage, these employees may also not be very concerned about their fellow colleagues and may not offer any guidance or be responsible for them. ❐

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Project Management Team Handling Challenges to Multinational Corporation

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Introduction

Bausch & Lomb Inc. chose to establish a $13 million joint venture in India for the purpose of producing and marketing high quality eye care and optical products in India and adjacent countries. The Indian market was viewed by Bausch & Lomb as an opportunity to satisfy the demands of a large emerging middle class population in a country whose total population of 1240 million people is the second largest in the world.

In recent years, India has been moving toward a more open economy encouraging multinationals to form joint ventures with local firms. To promote foreign investment, the Indian government has reduced tariffs on imported raw materials.

This was Bausch & Lomb's first venture into the Indian subcontinent. Supported by the staff of a prominent eye institute in Hyderabad, and teamed with Bausch & Lomb eye care professionals, training of Indian eye care practitioners (ophthalmologists and optometrists) began immediately to support the development of the soft contact lens business there.

It was necessary to overcome major obstacles to complete the manufacturing facility. Bureaucratic paperwork, different management styles, high import duties, lack of available electric power, water, sewers, and limited communications networks created uncommon problems. These issues challenged the multinational project team in the Indian environment.

Bausch & Lomb's style of management is participatory with heavy emphasis on team work. This contrasts with the more autocratic style prevalent among many Indian firms. "There are clear demarcations between management and lower level employees. Discussions via labor unions are common; overtly expressed dissatisfaction is rare".

While this presentation will describe project experiences in India, the lessons learned are applicable to most developing countries. Unlike countries in the former Soviet Union, India has remained a closed economy for decades. This presented several unknowns to the team requiring mid-course corrections during the project. The multinational project team was quickly formed, and an Indian architectural and engineering firm (Tata) was selected. Actual production started in June 1992, seventeen months after groundbreaking.

Scope

For project objectives to be met, production needed to start within seventeen months from approval date, and total capital costs needed to be within the approved $13 million budget. All products produced needed to meet Bausch & Lomb's international quality standards.

Detailed construction drawings and specifications were developed by Tata to Bausch &. Lomb's concept drawings and performance specification. A complete detailed work breakdown structure was prepared by the protean for each product line with planned construction completion dates. Reporting of cost, schedule, and technical performance status occurred monthly by each product line team member with key issues and action noted.

Team members were selected by the project manager for their expertise and their flexibility toward foreign cultures and their ability to work as part of a multinational team. Once the project team was formed, a successful four-day design conference was held in Europe to finalize technical details impacting the design of the 70,000-square-foot manufacturing facility. Fifteen technical representatives from Bausch &. Lomb Inc., the joint venture (Bausch Lomb India Ltd.), and Tata participated. Basic facility parameters were established including all utility capacities, space requirements, and product work flow, plant expansion strategies, etc.

From this conference came the realization that the project was under-capitalized. Original assumptions needed revision. Equipment originally planned for Indian manufacture now needed to be imported at increased cost due to lack of Indian manufacturing capability for specialized equipment. Over $2 million in new costs were offset by selective reductions in optional equipment, favorable reductions in duty rates, and by subcontracting one product line (enzyme tablets). The Plant capacity plan was met and is capable of initially supporting sales for projected fifth-year volumes with designed-in expansion capability double capacity in later years.

Time Management

To meet the planned completion targets, a fast-track approach was implemented for building construction. The nearly $2 million in additional costs (noted above) for scope changes were required to compensate for the lack of available power, water, and effluent treatment as well as account for lack of locally available specialized equipment.

Importing special-purpose equipment proved to be not only costly in money (100+ percent duty), but also in time. In many cases, up to three months were required to clear Indian customs. The paperwork needed to be impeccable—otherwise a long delay could be expected.

Even though the team experienced custom clearance delays as well as delays in commercially available power for the plant, production still started seventeen months after groundbreaking. This was achieved by training at other Bausch & Lomb plants and by a phased production start-up utilizing imported semi-finished products.

Quality Management

We learned quickly that it was essential to import high precision, sophisticated special purpose equipment. Locally, the state-of-art for most equipment is 1940s technology. This is especially true in the machine tool sector. Much of our precision equipment was imported from Germany, Hong Kong, and United States.

A key part of this project included designing and building the manufacturing facility to produce products to worldwide specifications. The international standard is aimed primarily at preventing and detecting any nonconformity during production and at implementing systems to prevent recurrence. The government inspections are required annually for the new plant; conformance to local codes and standards is expected—particularly from multinationals.

Legal contracts appear to be less important in India than in the United States. This is due largely to the cumbersome legal system at present. However, specific contracts were established for the architectural and engineering work and the civil contractor. Fortunately, no major problems arose during the execution of these contracts.

Prior to beginning production, each process was validated and each product was subjected to standard product qualification testing to ensure that all performance parameters were met. Once these validations and qualifications were successfully completed, a start-up audit was conducted, and approval was then given from Corporate Quality Assurance to begin production. Quarterly product/process audits are performed for the facility by Bausch & Lomb representatives from the United States and Europe.

Risk Management

Producing a high-quality product in India is a risk in itself. Facility of construction techniques are highly manual, slow and of poor quality. The only major piece of construction equipment at the site was a small concrete mixer. All other tasks were performed manually. Over 300 laborers were at site during the peak construction period. The joint venture acted as the general contractor, as is the custom in India. External risks that were unpredictable were :

- change in government regulations, such as duty rates, excise taxes, etc.
- unavailability of basic services such as water, electric power, telecommunications, and specialized vendors
- lack of skilled manpower—particularly in areas such as computer skills, mechanics, electricians, etc.

- bureaucratic serendipity-government approvals to import equipment took months with the prospect of rejection.

Communication Management

The projects in the international sector were staffed with a project manager and technical support team based at its United States headquarters and a joint venture team at site.

Once the project was under way, we learned that this would not be adequate for a project of this complexity in a Third-World environment where changes occur daily. We then stepped up our on-site support to maximize the number of technical personnel from Bausch & Lomb.

No fax communication is available, and local phone communications are unreliable. No interna-tional phone or communication is possible so all must be handled through the office in New Delhi. Couriers carry messages daily from the New Delhi office to the plant.

In response, the project team members spent up to three weeks per trip each quarter in India to meet the start-up schedule. Product line engineers from Bausch & Lomb worked on rotating schedule coverage at the plant site. For each product line there near present was to respond to immediate needs and to communicate with other team members via fax or phone from New Delhi. This worked well and avoided long stays in India.

The prize was the satisfaction of a very difficult job well done by a world-class multinational project team.

Factors for Success

- Hold a technical design conference to finalize design parameters and identify risks. Detailed engineering work can then begin.
- Select an in-country architectural and engineering firm that understands local culture and has experience with similar work.
- Select a good joint venture partner who knows local market and how to deal with the bureaucracy.
- Organize a competent, well-motivated team and recognize it for its contributions.
- Pick a good scheduling system that is user-friendly.
- Select a good plant location, and design the facility logical expansion.
- Get marketing to commit to a sales forecast. While easier said than done, this is critical to capacity planning.
- Know and test assumptions.

Conclusion

The project was not possible to be successful without using techniques of "Project Management". With the support of the total project team, the project came under budget, despite equipment delays at customs and delays in commercially available power. Today this plant manufactures products that meet worldwide quality standards.

The team members were selected by the Project Manager for their expertise, their flexibility toward foreign cultures, and their ability to work as part of a multinational team.

The management style was quite different from the typical style in Indian firms—to face a number of external risks were unpredictable. The Project Managers are sometimes challenged with major bureaucratic obstacles and ethical dilemmas for the project manager without looking for shortcuts.

This project proved that it is possible to produce high-quality products in India to international quality standards. Accomplishing this required significant training, high-quality equipment, a positive attitude, and support from our Indian joint venture partner. ❐

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Sustainable Development : Few Aspects in Indian Banking Sector

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Introduction

The Indian banking sector has experienced progression on various directions in the last decade, they have seen much focus on economic progress and many have taken giant steps in its journey through time. The regulators of this sector have made notable efforts to improve innovation, growth and value creation to sustain the havocs of financial crises in recent past. However, concern at global level is that mere economic growth and profitability may not address environmental liabilities, and we need to take special effort to encourage sustainable development across industries.

This sustainable development is nothing but the continuity of economic progress for present generation without damaging the ecology or destroying the available resources for future generation. It is beyond matters of sheer corporate social responsibility or ethical norms. All sectors of the economy, government, NGOs, corporate, citizens and definitely the financial sector have impact, direct or indirect on the environment for their activities in society. This exploratory study tries to gather some of the efforts made at international level to address issues of sustainable development and suggest a model based on few parameters that banks in India may adapt to assess sustainable growth efforts made by their prospective borrower clients.

Though a bank's own activity may be considered environment friendly in terms of emissions and pollutions, but the environmental impact of bank's external activity is enormous and difficult to quantify. Their contribution in financing various types of projects across industries cannot be ignored. Globally, firms and industries are exposed to strict environmental policies and are under the scanner of stringent laws, therefore, it also becomes easier for financial institutions, in such countries, to assess and report their contribution and progress in sustainable development.

The banking sector, especially in India, need to tackle sustainable development issue through the activities of their customers whom they serve. The concept of ''green banking'', as mentioned by Sahoo P. and Nayak B.P. (2008), will not only ensure the greening of the industries but will also facilitate in improving the asset quality of banks in future. The role of banks in assessment of projects for financing and priority lending purpose would influence customer activities that encourage ecologically viable industries and play a critical role to promote environmentally sustainable and socially responsible industrial activities.

The aspect of social audit and client assessment

Various agencies, consortiums and development institutions across the world have been advocating for environmental standards and strategies to evaluate investment projects. United Nations Environment Program and Finance Initiative (UNEPFI) was launched in 1990s to promote sustainable development within the framework of market mechanisms; even earlier to this, the U.S. Comprehensive Environmental Response Compensation and Liability Act in the 1980's has resulted in huge loss to several banks in the US for polluting the environment from activities of their clients and made them pay the remediation cost. In another case, a global network of civil society organizations and individuals came together to create an organization named Bank Track. It tracks the operations of private financial sector (commercial banks, investors, insurance companies etc) and its effect on people and planet. This has contributed remarkably to safeguard policies covering environmental assessment, natural habitats, pest management, child and forced labor issues, and various other social causes mostly in the Western world.

A summarized report by Sullivan & Cromwell (2003) on the 'Equator Principles—New Environmental and Social Guidelines for Project Finance Transactions' was made available as practices and policies that would be expected to permit banks to provide direct loans and meet substantive standards. The principles therein indicated criteria that include various environmental and social screening procedures that need to be followed by a project borrower in order to obtain finance from banks. Some of the banks who have initially adopted the Equator Principles include Barclays Bank plc, Royal Bank of Scotland, Citigroup and a few others, though the practical effects of these policies would certainly depend on individual internal practices existing in these banks.

A global level survey conducted by Mckinsey & Company to explore why and how companies are addressing sustainability in various industries found that many successful companies had considered long-term strategic view of sustainability built into their three key value creation areas: Return on Capital, Growth and Risk Management. The report is an eye-opener to several companies functioning in various industries as well as the financing institutions that support their projects. The implication for banking institutions who deliberately finance projects after making due Environmental Assessment and following rigid regulations are manifold Banks could reduce their credit risk as a result of customers defaulting on consequence of their uncalculated expenses for capital investment made in projects which are environmentally unviable; they may also reduce their exposure to legal risks as direct lender liability for ecological damages made by its customers who have financed their projects; and last but not least, with the growing awareness of sustainable development, financing institutions are also prone to loose their reputation for financing ecologically and ethically questionable projects. Hence for banking institutions to reduce such risks and maintain good reputation in the market, sustainable development aspects have to be positively addressed.

Efforts for Indian Banking Sector

Indian banking sector has shown many positive developments in the last decade by having made notable efforts to improve regulation in the sector. It is growing rapidly, its role and contribution in keeping the Indian economy stable even during the financial turbulence worldwide, is a matter of appreciation. Some banks have even shown outstanding track records of innovation, growth and value creation over the years. Many of the Indian banks are pursuing global strategies in order to fundamentally upgrade organizational capability to stay in tune with the changing market and global growth. However, financing industries that compromise the ethical norms by creating loss of biodiversity, environmental damage and climate change, is definitely not asked for and in the long run create substandard assets for them. Hence banks need to assess their borrower clients carefully to prevent financing hazardous projects that would expose them to credit as well as legal risks with the passage of time.

In India too, the fear of depletion of natural resources and degradation of the environment has attracted attention of several organizations and researches to make studies that would help in sustainable development of the economy. One study report named 'Sustainable Green Banking : The story of Triodos Bank', by R.N. Dash (2008), has demonstrated how a bank, licensed under the Dutch Central Bank, in small town of Zeist, has successfully supported sustainable performance of industries in its country. The study reveals the unique method of lending process of this bank where apart from analysis of the firms' data, gathers information from human rights organizations, multilateral agencies, international consortiums and such other sources that may be relevant. Lending portfolio as available in that study may provide us guidance in regard to social and environmental audit procedure; the illustration is as below:

Exhibit 1 : For Environment and Social Audit in the Bank

Sl. No.	Segment	What it includes	Share in total lending
1	Nature and Environment	Projects in the field of renewal energy (wind energy & hydro-electric projects), organic agriculture across the entire value chain including health, food shops and environment techno-logy such as recycling companies and nature conservative projects.	Percentage
2	Culture and welfare	Small loans to artists and organizations actively involved in education, healthcare or providing aid to people with physical and learning disabilities. All these enterprises have a clear people-centered policy.	Percentage
3	Social Business	Loans to traditional business and innovation enterprises and services providers with clear social goals, including financing of start-up enterprises, fair trade businesses and microfinance institutions providing basic financial services for people in the developing world.	Percentage Percentage
4	Any other area under the regu-lation of the Government, International and National consortiums or other such bodies.	Suitable criteria	

Source: 'Sustainable Green Banking : The story of Triodos Bank' by R. N. Dash (2008), suitable modified for this study

In a similar fashion, banks in India need to help bridge the gap between economic growth and the issues of sustainable development for the country. Each bank may have its own policies and practices for assessing lending criteria to its prospective clients; but a defined combination of environmental, societal, and governance issues may be set as parameters to assess the projects and accompany the project analysis report in addition to the usual and normal indicators. Below is given an indicative model that may help in sustainability assessment of the business for financing purpose to the clients' upcoming project.

Exhibit 2 : Client Assessment Model

Sustainability integrated in the following business processes of the organization to be assessed before financing projects.	Mission and Values, Strategic Planning, Corporate Culture, Operations, Employee engagement, Internal Communications, Budgeting Process, Marketing, Supply Chain Management, External Communication etc.
Further breakup for analyzing the credit applications of the prospective clients (these breakups are only indicative and more and more parameters may be set by banks, and responses noted for analysis both qualitatively and quantitatively)	
Reducing energy use in operations	Yes considerably
Reducing waste from operations	Yes
Managing corporate reputation for sustainability	Yes noticeably
Responding to regulatory constraints or opportunities	Yes in true sense
Reducing emissions from operations, and presence of treatment plants	Yes
Managing services/products portfolio to capture trends in sustainability	Yes
Reducing water use in operations	Yes
Committing R&D resources to sustainable products	Yes significantly
Leveraging sustainability of existing products to reach new customers or markets	Provisions present
Managing impact of products and packaging through the value chain	Yes
Improving employee retention and/or motivation related to sustainable activities	Good HR policies
Mitigating operational risk related to external forces	Provisions made
Achieving greater market share from sustainable products	Yes

Source : McKinsey Global Survey results, October 2011, suitably modified for this study.

Concluding

Banks have substantial influence on economic growth and can play major role in determining the nature of growth both in terms of quality and quantity. Banks can encourage environmentally responsible investments by its customers that would play an important role in creating linkage between economic development and protection of the nature. This would subsequently facilitate in improving asset quality of many banks in future. Worldwide it has been an issue of concern, of how commercial banks, being important source of finance for companies and governments, can exert great influence on operations of their clients to control environmental degradation.

The banks could address issues of sustainable development, governance, accountability, transparency, reporting and risk management need to become integral to the interest of all stakeholders. They can make sure that their clients integrate environmental, social and governance issues into their strategic planning of business model and act under stringent regulation. This would create transparency and accountability at their end would help these companies strengthen their competitive position, have long-term strategic view and identify opportunities of growth that are economically viable and at the same time prevent damage of our environment. ❐

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'Crime and Punishment': An introspection into two infamous financial reporting frauds across the world

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The financial crimes (and frauds) are not less dangerous than the murders in real life rather have been the causes of many real life murders, known or unknown, and steadily progress disaster in personal lives of many. In general, one should agree with me in two points about the nature of financial crimes that they can not usually be committed alone and to commit these crimes people need super-intelligence. Because, in any country of the world there is an extant system of legislation mainly with the objective of prevention of crime. Like any other legislation, the basic objective of which is to prevent the possible concerned crime in the first instance, and if at all any crime takes place flouting the said law, there should be provisions in the law for punishment. So, there are many people to connive if the law is to be violated. In spite of that, such crimes and frauds are taking place, from time to time, and from one country to the other. Most astonishingly, financial crimes have been occurring not only in a country of lenient compliance system of punishment like India but also in the countries having a stringent system of imposing punishment like the United States. In this context, two infamous financial scams, Enron scandal (2001) in U.S.A. and Satyam Computer scam (2009) in India that have taken place in two ends of the last decade, but in two different countries, specially having a different mode of compliance system, are taken up for discussion.

Financial reporting scams caused by 'creative accounting' (though it may be a misnomer) are distinctly different from the securities market based scams. Financial scams are far in-depth and take time to get unfolded because the initial public loss remains dormant. The time of releasing out the extent of damage depends upon the nature of efficiency in conduction of crime.

Enron scandal (2001) in U.S.A. and Satyam scam (2009) in India, when investigated into reveal many similarities in conduction of the 'crime' as well as in respect of the extant legislations before the occurrence of such crimes in the respective countries. The prime accused persons in both these scams have also been in control of the respective companies before the news of the scams came into public knowledge. After the Enron debacle, auditing all over the world has come under the scanner. The age-old saying that 'an auditor is a watchdog and not a blood hound' is being re-examined, if not questioned. Legislation which seeks to lay a greater emphasis on detection and reporting of fraud by auditors has been introduced all over the globe. Sarbanes Oxley Act (SOX) was introduced in the United States as a reactive measure in the aftermath of the scam whereas clause 49 was floated as a pro-active measure in India. Yet, the principal reasons as investigated into both the countries do not establish that there was not sufficient law before occurrence of these scams. That is why Satyam Computer scam, as titled later as 'India's Enron scam', may have taken place.

Urging upon the ethical aspect of auditors and other concerned persons becomes popular as long time remedial measure than making the legislation further stringent. But, that not being objectively measurable, the present paper suggests to give more importance on the twin tools of enhanced scrutiny and deterrent punishment towards minimizing the probability of scams and their size.

Why These two scams of the two countries being selected in the study?

It may appear to be a mere coincidence but the two companies in the two countries far off from each other, the companies also being far off in their industries of operation evolved almost similarly. However, these two companies faced the same sort of events in the process of being the leaders in the respective industries in the said countries. Enron started business as an energy supplier in 1985. Two years later, Satyam set up shop to provide IT services to the companies abroad. By 1996, Enron started trading in energy contracts and by December 2000 claimed that its profits tripled in just two years. Just before its liquidation in late 2001, Enron was regarded as one of the world's leading energy companies with over 20,000 employees and a revenue claim of over $100 billion in 2000. Also, for six years in a row, Enron was "America's most innovative company". Satyam too had one time nearly 53,000 employees and had been the country's fourth biggest IT firm. It had also won various innovation accolades and awards for its corporate governance. Satyam was ranked high by the international media that said the IT company was catching up fast with the big three Indian software exporters, TCS, Infosys and Wipro.

Now, it will be more interesting to see the before and aftermath of these scams in these two countries. Because, basically the nature of these two scams is same, which has already been mentioned as a product of creative accounting and earnings management. Enron hid its debts to make growth look impressive. Satyam founder, Ramalinga Raju too inflated cash and bank balances, reported accrued interest that was non-existent, understated liabilities and over-stated debtors' position.

There is another motivation behind selection of these two particular scams, rather the two countries where these two scams took place. The country, which basically houses Enron, is considered to be the leader of the present-day politically viewed unipolar world and one of the most economically rich countries housing the registered offices of most of the big TNCs. Further, the country is widely considered to be one having a very sound legislation. More importantly, the country is famous for the meticulous compliance of the legislation. Whereas, India, bearing the largest democratic political system, housed once the largest number of stock exchange-listed companies in the world and is still being a country with leading number of listed companies. The country is widely considered economically to be a developing nation. The country too has a much experienced and celebrated set-up of various laws, more akin to her one-time political ruler, the United Kingdom. The corporate laws and governance systems are no exception to this. But, compliance of the laws is in general poor; the judiciary also suffers from an inherent system-based sluggishness. The country has also become infamous for various financial scams in recent past in which politically elected personnel got involved. In most of the cases of financial scams in India, especially in the infamous securities market scam of 1992, very minimum punishment could ultimately be imposed.

The First White-Collar Crime : Enron scam in the United States

In 2001, Enron suffered the largest bankruptcy case in history, after a series of revelations involving irregular accounting procedures bordering on fraud perpetrated throughout the 1990s involving Enron and its accounting firm Arthur Andersen. The scam surpasses even the other infamous scams taken place in WorldCom in 2002 and Lehman Brothers in 2008 in the same country if the amount of fraud and various losses are considered. "Judge Lake revealed that the size of the fraud linked to Skilling's actions was considered by the court to be $80 million. ... Thousands of jobs and $2 billion of pension funds were lost while the 2001 bankruptcy wiped out $60 billion of Enron's market value" (*The Times*, New York, October 24, 2006). Enron filed for bankruptcy on December 2, 2001.

As the scandal unraveled, Enron shares dropped from over US$90 in the summer of 2000 to just pennies in the early 2002. Enron had been considered a blue chip stock, so this was an unprecedented and disastrous event in the financial world. Enron's plunge occurred after it was revealed that much of its profits and revenue were the result of deals with special purpose entities (limited partnerships which it controlled). The result was that many of Enron's debts and the losses that it suffered were not reported in its financial statements.

Just four days before Enron disclosed a stunning $618 million loss for the third quarter in 2001-2002, its first public disclosure of its financial woes, workers who audited the company's books for Arthur Andersen, received an extraordinary instruction from one of the company's lawyers. Congressional investigators tell *The Times* (New York) that the October 12 memo directed workers to destroy all audit material, except for the most basic "work papers". And that is what they did, over a period of several weeks. As a result, FBI investigators, congressional probers and workers sued the company. Since the Securities Exchange Commission (SEC) is not allowed to accept audits from convicted auditors, Andersen was forced to stop from being given audit assignment in the public companies. Although the conviction was thrown out in 2005 by the Supreme Court, the damage to the Andersen name has prevented it from returning as to its position even on a limited scale. This ultimately led to the dissolution of Arthur Andersen, which at the time was one of the world's top accounting firms.

Enron had created offshore entities and units which may be used for planning and avoidance of taxes, raising the profitability of a business. This provided ownership and management with full freedom of currency movement and the anonymity that allowed the company to hide losses. These entities made Enron look more profitable than it actually was. This practice drove up their stock price to new levels, at which point the executives began to work on insider information and traded millions of dollars worth of Enron stock. The executives and insiders at Enron knew about the offshore accounts that were hiding losses for the company; however, the investors knew nothing of this. Chief Financial Officer, Andrew Fastow led the team which created the off-the-books companies, and manipulated the deals to provide himself, his family, and his friends with hundreds of millions of dollars in guaranteed revenue, at the expense of Enron and its stockholders.

Further, under the direction of Enron president and chief operating officer, Jeffrey Skilling, the company adopted 'mark to market accounting', in which anticipated future profits from any deal were tabulated as if assuming them real today. Thus, Enron could record gains from what over time might turn out to be losses, as the company's fiscal health became secondary to manipulating its stock price on *Wall Street* during the technology boom. But when a company's success is measured by agreeable financial statements emerging from a 'black box', a term Skilling himself admitted, actual balance sheets prove inconvenient. The *Wall Street* analyst, Richard Grubman had complained that Enron was the only company that could not release a balance sheet along with its earnings statements. When asked during his trial, Skilling wholeheartedly admitted that 'industrial dominance and abuse had been a global problem'. For reference sake, it should be mentioned here that Kenneth Lay was the CEO and chairman of Enron from 1985 until his resignation on January 23, 2002, except for a few months in 2000 when he was the Chairman and Jeffrey Skilling was the CEO.

In August 2000, Enron's stock price hit its highest value of $90. At this point, Enron executives, who possessed the inside information on the hidden losses, began to sell their stock. At the same time, the general public and Enron's investors were told to buy the stock. Executives told the investors that the stock would continue to climb until it reached possibly the $130 to $140 range, while secretly unloading their shares. As executives sold their shares, the price began to drop. As Lay did many times in the history of the company whenever any small news came in public knowledge which might have a negative impact upon the investment market, he would issue a statement or make an appearance to calm investors and assure them that Enron was headed in the right direction. This time too, the investors were told to continue buying stock or hold steady if they already owned Enron because the stock price would rebound in the near future. By August 15, 2001, Enron's stock price had fallen to $42. Many of the investors still trusted Lay and believed that Enron would rule the market. They continued to buy or hold their stock and lost more money every day. As October closed, the stock had fallen to $15. Many saw this as a further great opportunity to buy Enron stock because of what Lay had been telling them in the media. Their trust and optimism proved to be greatly misplaced.

Lay has been accused of selling over $70 million worth of stock at this time, which he used to repay cash advances on lines of credit. He sold another $20 million worth of stock in the open market. Also, Lay's wife, Linda, has been accused of selling 500,000 shares of Enron stock totaling $1.2 million on November 28, 2001. The money earned from this sale did not go to the family but rather to the charitable organizations, which had already received pledges of contributions from the foundation. Former Enron executive, Paula Rieker has been charged with criminal insider trading. Rieker obtained 18,380 Enron shares for $15.51 a share. She sold that stock for $49.77 a share in July 2001, a week before the public was told what she already knew about the $102 million loss.

It is reported that Enron enjoyed considerable influence from the start of the Bush Administration. Curtis Hebert Jr., the former chairman of the Federal Energy Regulatory Commission, told *the Times*, New York that Lay offered to support Hebert's continuing in that role if Hebert would take a friendlier view toward energy deregulation. Hebert declined, and the Bush Administration replaced him. Lay and other Enron officials met six times with officials led by Vice President Dick Cheney, a former oilman, to craft a new energy policy. That policy, not surprisingly, was friendly to Enron and other energy companies. While Bush and the Republicans have gained the lion's share of attention from Enron and Lay, they get at least a little cover from the company's campaign contributions to prominent Democrats, such as Senate Energy Committee Chairman, Jeff Bingaman and Louisiana Senator, John Breaux. Enron and its top officials have hired the well-known Democratic lawyers, Robert Bennett and David Boies.

Shortly after emerging from bankruptcy in November 2004, Enron's new board of directors sued 11 financial institutions for helping Lay, Fastow, Skilling and others for hiding Enron's true financial condition. Among the defendants were Royal Bank of Scotland, Deutsche Bank and Citigroup.[update] Enron was able to obtain nearly $20 billion dollars to distribute to its creditors as a result of the mega claims' litigation. As of December 2009, some claim and process payments are still being distributed.

The Initial Reaction in the United States

Reacting to the Enron scandal, Norman (2004) argues that new ways of holding senior executives accountable in a stakeholder-oriented (multiple-objective) firm must be found. He calls for reducing the discretion given to the managers in choosing between maximization of profit and that of multiple stakeholder benefits. He further alleges that the board of directors cannot effectively judge whether the top management is doing a good job if it does not have a specific exclusive measurable target. The standards for measuring improvement in some areas of stakeholder benefit are likely to be flexible, if not ambiguous. Therefore, the board has to assume that management is deeply committed to a corporate social responsibility mission. That, however, cannot be verified. Moreover, accepting the existence of moral hazard, the corruption of agents is likely to appear, in which case the program of multiple stakeholder benefits may become not only inefficient, but fraudulent.

The practice of co-sourcing, as it is called, of internal audits gained popularity in the US following the Enron scam. Outsourcing internal audit practice served several purposes for corporate houses, including enhancing the brand value of the company. Earlier, at the time of investing in a firm, private equity investors only looked at the statutory audit records. However an increasing emphasis is also being given to internal audit at present.

The Second White-Collar Crime : Satyam Computer scam in India

In an announcement that sent shock waves across corporate India, Chairman of Satyam Computer Services Ltd., once the third largest software services company in India, B. Ramalinga Raju resigned from the board, admitting India Inc.'s biggest fraud amounting US$ 1.44 billion. Soon after, Satyam's Managing Director and Ramalinga's brother, B. Rama Raju, too followed suit. In a letter to the board, B. Ramalinga Raju admitted that there were inflated (or non-existent) cash and bank balances of 50.40 billion INR (the amount reflected in the books being 53. 61 billion INR). There was also a receipt of accrued interest amounting to 3.76 billion INR, which was non-existent. The balance sheet also had an understated liability of 12.30 billion INR on account of funds arranged by Raju. The debtors' position was also overstated to 26.51 billion INR (the increase being 4.90 billion INR). Raju admitted that the September 2008 results were overstated at 27 billion INR with an operating margin of 6.49 billion INR (the actual corresponding figures being 21.12 billion and 0.61 billion INR respectively, resulting in an artificial cash balance of 5.88 billion INR). Raju also admitted that Satyam's profits were inflated over several years. He said that what started as a marginal gap between the actual operating profit and the reported profit attained unmanageable disproportionate increase as the size of the company grew and every attempt to eliminate that gap failed. He added, "It was like riding a tiger, not knowing how to get off without being eaten". The Maytas deal was the last attempt to replace the fictitious assets with real ones. Analysts indicated that the size of the fraud could be much higher, considering that the figure of about 80 billion INR was disclosed by the company chairman himself.

Raju stated that 12.30 billion INR was arranged for Satyam, not being reflected in its books, just to keep Satyam's operations running. And, for this, the promoter had to pledge the promoter's shares and raise funds from other sources. Facing the threat of a hostile takeover by a domestic or overseas company, including private equity firms, Satyam Computer Services' management and some of its institutional investors started exploring the possibility of merger with another software company.

Raju started an IT company with 20 employees and bagged a multitude of IT projects from the US companies. The said company developed rapidly and became a true multinational company with thousands of employees spread over a number of countries. The latest Maytas controversy and margin selling of his shares created a furore in the business circles. Satyam Computers had announced on December 16, 2008 that it would acquire two group firms – Maytas Properties and Maytas Infra for 80 billion INR (about $1.6 billion) as a part of its diversification strategy – a move that sparked a row over alleged violation of corporate governance norms. The Satyam Board, including its five independent directors, had approved the founder's proposal to buy 51 per cent stake in Maytas Infrastructure and 100 per cent stake in Maytas Properties, owned by the family members of B. Ramalinga Raju. The decision of acquisition, however, came under severe criticism from the institutional shareholders, especially the overseas ones, which forced Satyam Computers to reverse its decision to invest 80 billion INR in the two promoter-owned companies. Four independent directors resigned thereafter, facing criticism for agreeing to a decision widely perceived as damaging to the company's interests. Its scrip nosedived more than 55 per cent on the US bourses. The Ministry of Corporate Affairs later ordered a probe into whether the company violated any corporate governance norms while entering into such a deal, involving shareholders' money.

The company's share price fell by 21.3 per cent since December 15, the day before the crisis broke. But, the Bombay Stock Exchange benchmark, Sensex crashed on 7th January, 2009 and tumbled over 749 points at noon to dip below the psychological 10,000-points level on heavy selling by funds after reports of Satyam Computer Services' chairman's resignation ahead of the crucial 10th January board meeting. On the same date, the index-linked Satyam Computer equity plunged by Rs. 139 (or 350 per cent) to Rs. 39.95. With the mounting selling pressure, the wide-base National Stock Exchange's index, Nifty, dropped by 192 points to 2,920.40 at the same time.

The Initial Reaction in India

Terming disclosures of financial wrong-doings at Satyam as an event of "horrifying magnitude", the Indian stock market regulator, SEBI said just on the day of the news made public that it would take all steps under the law for which it has started discussions with government and bourses. "We are in touch with Ministry of Corporate Affairs... we are also in discussion with them as to what steps need to be taken from the perspective of power they have under the law and SEBI has under the law," SEBI Chairman, C. B. Bhave said to a business TV channel. In fact, the Ministry of Corporate Affairs said that the role of directors and auditors at Satyam would be scanned by The Institute of Chartered Accountants of India (ICAI), the apex institute of the professional Auditors in India and The Institute of Company Secretaries of India (ICSI), the apex body of company Secretaries in India (*The Economic Times*, Jan. 7, 2009).

In early 2009, immediately following the accounting fraud at Satyam, several committees and task forces were constituted to review corporate governance norms and practices in India. Some of them issued their recommendations late last year. These include a report by a task force constituted by the Confederation of Indian Industry (CII) and another by the Institute of Company Secretaries of India. Based on these reports / recommendations, the Ministry of Corporate Affairs, Government of India issued the Corporate Governance Voluntary Guidelines 2009 in December, 2009.

During late April of 2010, another Committee that was constituted by Nasscom, the premier trade body and the chamber of commerce of the IT-BPO industries in India, headed by N. R. Narayana Murthy issued its recommendations for further strengthening corporate governance practices in India. At the outset, the appointment of a committee by the IT industry body is understandable because the fraud and governance failures at Satyam put the credibility of the IT-BPO industry in India at stake. Hence, the recommendations too are primarily focused at that industry, although it is intended to be applicable to other industries as well. The recommendations of the committee regarding board structure, independence of directors, audit committee and disclosures to shareholders substantially overlap with the ground that has already been covered by the previous task forces and committees. However, a distinctive feature of the Nasscom recommendations is that they adopt a more holistic approach and focus heavily on the protection of stakeholders in a company such as customers, employees, other partners such as vendors, and even competitors. To that extent, they represent a marked departure from previous governance reform measures that focus almost solely on protection of shareholder interests.

The Law Existing in the US Before the Enron SCAM

"The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities .... at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates." (Enron Annual Report, 2000, p. 36).

The Enron experience reveals a problem at the heart of US accounting - with the FASB's conceptual framework that encourages and legitimates creative accounting. At the centre of the Enron scandal are the US rules for consolidated accounting, but as these rules define what is and what is not an accounting entity—what is and what is not an 'asset' of the parent undertaking—they have profound effect on accounting for all transactions between undertakings. Enron used these rules to exploit 'Special Purpose Entities' (or Vehicles) (SPEs or SPVs), businesses that it claimed it did not control and should not consolidate

—to hide losses on its investments, to hide liabilities and to generate fictitious profits.

Rob Bryer (2004) argues that Enron's accounting shows just how deeply the capital market's view of value as economic value is embedded as the dominant ideology of US accounting. This idea underlies the conceptual framework of the FASB and its acolytes in the British Accounting Standards Board (ASB) and the International Accounting Standards Board (IASB). He further argues that this ideology undermines accounting's traditional stewardship or accountability role. The lesson drawn for accountants is the profound weakness of the FASB's conceptual framework at the core of which is its definition of an asset as an expected cash inflow. He also argues that the traditional concept of conservatism as to the definition of an asset as the recoverable cost of a controlled use-value would have prevented Enron's accounting manipulations.

The Law Existing in India Before the Satyam Computer SCAM

Under Section 227 of the Indian Companies Act, the auditor is supposed to report to the beneficiaries of the company *i.e.* the shareholders in the general meeting, about the books and accounts of the company, the balance sheet and profit and loss account on the basis of their assessment. They have to give their opinion on the financial position of the company and also make sure that it has been fairly, truly and honestly depicted.

As per Section 227 of the Indian Companies Act, the report should also state :

1. That the auditor has obtained all information and explanations, which are to the best of his knowledge and belief necessary for his purpose;
2. Whether in his opinion, all the books of accounts and requisite documents necessary for the audit have been furnished by the company;
3. Whether the balance sheet and profit and loss account comply with the books of accounts; and
4. Any observation and comments on the functioning of the company, especially, which may have an adverse effect on the company.

An auditor is thus required to report not merely on the balance sheet but on the accounts he examines, and he also has to express his opinion whether the company has properly kept all the books as per law and whether the balance sheet and profit and loss account are in accordance with the accounting standards and procedures prescribed by the ICAI. The report should be complete, concise, clear and unambiguous and the auditor should be careful about the language used, as the readers of the report are all laymen. Auditor's opinion can be qualified or unqualified. A qualified opinion is an opinion subject to certain reservations. That means that the auditor is unable to satisfy himself that the accounts present a true and fair view of the company's financial position.

As per Section 227(4) of the Companies Act, the nature and reasons of qualification should also be clearly stated, instead of merely stating grounds for suspicion. For the purpose of drawing up the report, the auditor is given the right to inspect and examine the books and accounts, balance sheets and vouchers or any other requisite documents necessary for the purpose of the audit. These documents can be accessed by the auditor at all times, irrespective of where they are kept. The auditor can also ask for any information and explanation from the officers of the company, and the officer would be under a duty to furnish the information and explanation so needed.

During the course of the audit, the auditor could come across situations where he discovers that a senior employee is defrauding the company or using unfair practices, then an obligation arises of the auditor to report what he has discovered to the management immediately so that appropriate action can be taken. If the auditor identifies the possible existence of fraud or other irregularities in accounting practices, the auditor should attempt to clarify it or report it. Once the fraud is detected, the auditor can investigate it further by authentication of original documents, actual tests and location visits, contacting major customers and suppliers, interviewing the personnel and testing the veracity of computer records. The auditor should then report of this to the director or the management, unless circumstances are such that their involvement is suspected. The possibility of detection is however a lot less in such cases. There may be circumstances, where the auditor needs to report to a third party without the consent and knowledge of the management, when he suspects that the management may be involved. The auditor should consider the magnitude of loss that will occur due to the fraud and irregularity and the number of people that will be affected by it or the possibility of recurrence of the fraud if gone unreported. As a measure of recoverable loss, the court noted that no losses would have been incurred from the date of discovery if the auditor had taken some action to blow the whistle [*Sasea Finance Ltd vs. KPMG* (2000) 1 BCLC 236 at 241, 242].

Section 233 of the Indian Companies Act imposes a penalty on the auditors for non-compliance of

Sections 227 and 229 with payment of fine if there is wilful negligence and default. The auditor may have to compensate the members or shareholders of the company who have suffered losses attributable to the negligence in performance of the auditor's duties. The auditor may be held liable for such fraud if there is negligence in detection of errors that may cause consequent loss to the company. In order to hold the auditor liable for fraud, the following conditions must be satisfied :

1. That the statement signed by the auditor is untrue and false;
2. That he knew it to be untrue either or did not apply reasonable care and skill;
3. That he intended the report to be relied on by others; and
4. That the parties on relying upon the report suffered loss.

The Indian Companies Act, 1956 imposes a Criminal liability under Section 628 on any person who makes a false or untrue statement through any document like balance sheet, profit and loss account, return, prospectus, intentionally, thereby causing a loss to the people who rely on such documents.

The Punishment Given in The United States

On July 7, 2004, Lay was indicted by a grand jury on 11 counts of securities fraud and related charges. On January 31, 2006, following four and a half years of preparation by government prosecutors, Lay's and Skilling's trial began in Houston. Lay was found guilty on May 25, 2006, of 10 counts against him; the judge dismissed the 11th. Because each count carried a maximum 5-year to 10-year sentence, legal experts said Lay could have faced 20 to 30 years in prison. However, he died while vacationing in Snowmass, Colorado on July 5, 2006, about three and a half months before his scheduled October 23 sentencing. Preliminary autopsy reports state that he died of a heart attack caused by coronary artery disease. As a result of his death, on October 17, 2006, the federal district court judge who presided over the case vacated Lay's conviction. There have been also been theories of conspiracy surrounding his death.

In one of the biggest corporate frauds of India, the Satyam financial scam's main accused, its former Chairman, Raju was arrested in January, 2009, and as a routine matter sought medical treatment due to health problem. On November 10, 2009, however, Raju surrendered before a court in Hyderabad after his 'more time' plea was rejected by the Supreme Court, the apex court in India. Raju and five other accused in the case decided to surrender before the magistrate after attending the court proceedings in the morning. This surrender came as a result of a directive of the apex court asking them to surrender.

Union Minister of State for Corporate Affairs, R. P. N. Singh has said that the investigation into Satyam Computer Services Limited is underway to ascertain siphoning of funds including role of individual directors. The scam is being investigated by Serious Fraud Investigation Office (SFIO), in association with Central Bureau of Investigation (CBI) & Enforcement Directorate (ED). Replying to a question in the Parliament recently, the Minister said disciplinary proceedings against six Chartered Accountants into the Satyam Computer Scam is underway by the ICAI and has not reached the stage of award of punishment. He said CBI has issued Letter of Rogatories to six countries. Since charge sheets will be filed after getting the information from these countries, no time limit can be indicated. ('**Investigation into Satyam Computer Scam under way',** March 3, 2011, *Tax Management India.com*.)

The Punishment Given In India

But, it is a matter of discomfort for Indian government that the concrete punishment in terms of imposition of financial penalties if any till now came from the United States, not till now from her own bodies.

US authorities have ordered PwC's Indian affiliates to pay $7.5 million in fines for deficiencies in its audits of Satyam Computer Services. The ruling is the first punishment handed down to an audit firm in connection to India's largest corporate fraud. The US Securities and Exchange Commission (SEC) has ordered Price Waterhouse firms pay $6 million in fines while the US Public Company Accounting Oversight Board (PCAOB) dished out a penalty of $1.5 million for violation in connection to the Satyam audit. In a related settlement with the SEC, Mahindra Satyam (previously Satyam Computer Services) agreed to settle fraud charges by paying a $10 million penalty and undertaking a series of internal reforms.

The PCAOB has settled disciplinary orders against Lovelock & Lewes, Price Waterhouse Bangalore, Price Waterhouse & Company Bangalore, and Price Waterhouse & Company Calcutta, known collectively as Price Waterhouse (PW) India. Only two of these firms were ordered to pay a $1.5 million fine. The PCAOB investigation found the jointly administered quality control systems of the five firms failed to detect a general practice in the cash confirmation process that was not in accordance with PCAOB standards. The oversight body said the deficient cash confirmation procedures contributed to the failure of PW India to detect the material overstatement of Satyam's cash balance. Satyam management used these bank confirmations as part of a cover up of its scheme to inflate the company's reported cash balance by $1billion approximately.

As a result, the affiliates will not be able to accept new engagements to audit US issuers until an independent monitor determines PW India has made significant progress toward completing the actions. According to the directive, PW India will also not be able to accept new referred US issuer audit work for six months.

The SEC ordered all five of PwC's Indian affiliates to pay a $6 million fine, which it said is for repeatedly conducting deficient audits of Satyam's financial statements and enabling a massive accounting fraud to go undetected for several years. The SEC said it found audit failures by the affiliates were not limited to Satyam, but rather symptomatic of a much larger quality control failure throughout PW India.

PW India said while it neither admits nor denies the US regulators' findings, its agreements with both the PCAOB and the SEC were important steps towards building upon the efforts it has made over the past two years to enhance its audit quality. The firm also hopes it can reach an agreed resolution with Indian regulators.

PwC International chairman Dennis Nally described India as a key market for the network and said it is committed to working with its colleagues in India to build on a successful quality practice.

The Consequent Changes Made In The Legislation of The Two Countries

After the Enron debacle, auditing all over the world has come under the scanner. The age-old saying that 'an auditor is a watchdog and not a blood hound' is being re-examined, if not questioned. Legislation which seeks to lay a greater emphasis on detection and reporting of fraud by auditors has been introduced all over the globe.

In the USA, corporate governance is regulated by several authorities. Corporations are subject to federal legislation, SEC rules and state laws. The most comprehensive reform of corporate governance law since the Securities and Exchange Act of 1934 was the Sarbanes-Oxley Corporate Reform Act of 2002 (SOA). As Morrison (2004) notes, SOA is not a new code of corporate governance, but rather a set of statutory reforms concerning financial controls, auditing and accounting. In a nutshell, most of the provisions of SOA concern the independence of members of the audit committee, a ban on auditors performing certain types of non-audit work, a revision of accounting standards for debts of special purpose entities, the disclosure of off-balance sheet transactions and the protection of so-called whistle-blowers. According to SOA, the CEO and the CFO must also certify annual reports, and may face criminal penalties in cases of reckless certification. SOA also prohibits personal loans to directors and disgorges incentive-based compensations and stock sales profits if accounts are overstated. It also requires senior financial officers to disclose their corporate code of ethics. The first requirement demands greater accountability of top management, as recommended by stakeholder theorists, while the following two could be seen as revisions of the original shareholder model. SOA does not address the problem of independent board directors, *per se*. Neither does it regulate equity-based compensation. These issues are however dealt with in the updated 2002 NYSE Listing Standards. According to which (1) the majority of the board should not have any material relationship with the company; (2) directors must hold meetings without managers present; (3) former employees of the company and its auditor must wait five years before serving on the board; (4) the audit committee must have sole responsibility for hiring the audit firm; (5) nominating and compensation committees must consist entirely of independent directors; and (6) shareholders must approve all share-based compensation.

Similar regulations were passed in other countries like Bill 198 or CSOX in Canada, J-SOX in Japan, CLERP 9 in Australia, and LSF in France. In India too, the Department of Company Affairs, then under the Ministry of Finance, appointed a Committee under the chairmanship of Naresh Chandra, former Cabinet Secretary to look into Corporate Audit and Governance in 2001. The Committee submitted its report in 2002. The principal regulator, SEBI already had clause 49 made compulsory beyond the year ended in 2003 for the listed companies incorporating most of the recommendations of the K.M. Birla Committee (which was appointed by the SEBI itself in 1999). SEBI constituted a Committee again on Corporate Governance under the chairmanship of N. R. Narayana Murthy in 2003. It also issued a circular in August 2003 revising clause 49 of the listing agreement. The Narayana Murthy Committee then considered and deliberated on the suggestions and comments on the circular. Based on the revised recommendations of the

Committee, provisions of clause 49 of the listing agreement were further revised on 29th October, 2004. Compliance of the revised clause 49 of the listing agreement was made mandatory since 1st January, 2006.

The End Note : 'Satyam—India's Enron'

The genesis of changes for SOX and Clause 49 are different. SOX was introduced in the United States as a reactive measure in the aftermath of Enron scam whereas clause 49 was floated as a pro-active measure in India also in the same circumstance. Yet, the principal reasons as investigated into both the countries do not establish that there was not sufficient law before occurrence of these scams. Rather, it is worth-mentioning that Enron received top scores from the "corporate governance" groups before it imploded. Its board of directors was 86 percent independent, and its audit committee consisted entirely of independent directors. The requirements of Sarbanes-Oxley would have barred only one of six members of its audit committee, a member who was a paid consultant to the company, from serving on it. No one had also alleged about any problem with the Enron's "internal controls," the heart of the costs of Sarbanes-Oxley. Enron was really not about internal controls; it was about accounting judgments. The best internal controls would not guard against bad judgments or misleading statements. That is what anti-fraud laws are for. SEBI also had the master circular in form of clause 49 of the listing agreement in India. Thus, the root of all exercises behind the scams appears to be very closely related to the deliberate negligence of the auditors. And in this respect, what the United States was able to do in the country, India is far behind of doing that. Now, a question may be put forward. Is deterrent punishment the panacea for all ills? The answer may be found in the analysis of one columnist on this subject that "it does serve its purpose in raising the stakes for players abusing the system" (Kabra, 2009).

Advocates of strong corporate social responsibility demand that top executives should work for the benefit of all stakeholders even if this means reduction of profit and shareholder value. In other words, they see profit as a necessary condition for sustainability of the business, but it should not be more important than the overall interest of the company which includes interests of other stakeholders. That is why 'credible' accounting should replace what is being projected and practised as 'creative accounting'. ❐

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* All the facts, statements and relevant information relating to two scams are presented on the basis of publication of the same in secondary sources. The author does not want to take any credit, if any, for that. However, the author has made an honest attempt in analysis of the same.

Corrigendum

In the April 2012 issue of The Management Accountant on page 392 the photograph of Shri S. Natarajan, the author of the article titled ''Cost Accounting Models for Pricing'' was wrongly printed. The Editor deeply regrets the unintentional error.

Black Money : Methods and Means of Controlling at Origin

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In the last two years or so, the entire country is discussing at length on the amount of illegal / Black Money that been slashed away in tax havens by the politicians, business people and others. It is an undisputed argument that if the entire illegal money which was accumulated by this bunch of people in illegal means could have been used for development, then India would have been at the top of the global economic power hierarchy today.

The systematic loopholes in the political and economic system coupled with socio-emotional weaknesses of the common people has been the major source of this black money generation in the country. This evil and economic devil has spread its wings from Parliament of India to the Municipality level. It is a hardcore reality in the country that today the entire election system and the candidates contesting the elections are driving the democratic process with Black Money—either directly or indirectly. This is really challenging the real democratic system of the country—making it difficult for the ordinary and intellectual class to participate in the system and get elected to law making institutions like Assembly and Parliament. As a result of this, only incompetent people with vested interests to make more and more illegal and black money are entering the parliament and assembly; and they are not making any competent and foolproof law in the country to curb the menace from grass routes.

Having seen the means and ways of generating blackmoney for the last decade, particularly for the last one year, let us understand how we can completely avoid this menace in the country. Let us call these steps as ''Reddy's Blackout'' tools :

1. Ban on physical possession of currency : The Government should impose strict restrictions indicating that at no point of time an individual should carry physical currency above Rs. 20,000. This also applies to the individual's residence. An individual is not allowed to have physical currency of more than Rs. 20,000 at any given point of time.

2. Ban on physical exchange of currency : Any Transaction involving a monetary value above Rs. 5,000 should be carried only by the electronic Banking / Cheque payment or though Debit or Credit card.

3. Linking all economic transactions with PAN : Any economic transaction which is above Rs. 5,000 need to be done either through cheque / Electronic payment / Debit card / Credit card. So all such transactions should be allowed to be carried on only if the Bank account, Debit card / Credit card are linked with the PAN of the accountholder. No person in the country will be allowed to transact involving monetary value above Rs. 5,000 if he or she does not have PAN.

4. Imposing limit on the number of Bank Accounts : Each and every person can have at the maximum four bank accounts and the same should be linked with PAN. At no point of time the person will be allowed to open a fifth account. So the banker, while opening the account, can check the details on the account on income tax website or the Government should allow the bankers to have a common database similar to the lines of NSDL where the banker can check how many existing accounts are linked to a particular PAN before allowing to open one more bank account.

5. Integrating Earnings—PAN—IT Return : A comprehensive step need to be taken by the government , all the person's spending above Rs. 5,000 per transaction in a year are captured with PAN. Also the PAN is linked to the person's income earnings. Subsequently when the person is buying some items costing Rs. 50,000 / - and above, then also the details are captured with PAN. This helps to understand and have a comprehensive view on the transactions of the person by the income tax department.

Now let us see what happens if the above five steps are followed in the economy :

***a. Ban on physical possession of currency* :** If stringent laws care passed with punishment like 10 years' imprisonment and with 10 times penalty of the money recovered if above Rs. 20,000 is found at any time with a person, then nobody would likely possess the cash in physical form. Apart from this the system itself drives away the need to have physical requirement of cash.

b. Ban on physical exchange of currency : Even if we have cash and if we know that we cannot use the same for the purchase of any item valuing beyond Rs. 5,000 in cash then we will not try to accumulate physical cash which is of no use if the conditions are imposed. Moreover, since all the purchases above Rs.5,000 / - can be done only with Debit / Credit cards / Net Banking, all the transactions are accounted and the persons are held responsible. This step, again, kills the need or usage of black money generation.

c. Linking all economic transactions with PAN : Currently most of the economic transactions like purchase of car, purchase of gold, purchase of land, etc are not linked to PAN. This lacking of integration of the transactions with PAN coupled with acceptance of cash as a settlement of transaction is really making the tracking or tracing of black money difficult. So banning the physical currency stock, banning the acceptance of physical money above Rs. 5,000 makes it mandatory for any person intending to procure / acquire the asset to use his legal and accounted money through Bank account / Net Banking / Debit / Credit card.

d. Imposing limit on the number of Bank Accounts : Opening bank accounts in numerous number and then closing the same after the transactions / making them dead is one of the simplest and easily followed method of black money generation in India. Most Individuals of economically high worthiness follow this route for the purpose. Imposing restrictions on the number of bank accounts make it difficult for involving it with balckmoney generation.

e. Integrating Earnings—PAN—IT Return : Now Income Tax earnings and returns are not integrating the PAN completely. Once the integration of earnings, spending and the IT return filed by the person is done it becomes easier to curb this menace.

If the above steps are followed with full will and spirit, then Indian economy will not see any kind of blackmoney in future with immediate effect. It is also a reality that today crores of rupees of illegal / black money is stashed in the hidden lockers of businessmen and politicians.

Now let us see how the Government should move in order to implement the above scheme :

- Let the Government—if it is serious on curbing black money—announce that no economic transaction valuing above Rs. 5,000 each will be permitted with effect from a specified date….(should be three months from the current date).
- The three months should be used and allowed for all the nationals to have bank account and to have the same integrated with PAN. If any person is having more than four bank accounts, then the same should be surrendered within these three months.
- The process to open the Bank Accounts should be made simple and cost effective. Nationalized banks should initiate steps to open the bank accounts for all common men within three months. Although this seems to be difficult at the outset, it is not so. This is actually a very simple one to accomplish since most of the persons in India already has the bank account.
- Once this is done all the payments of the Government to the citizens of the country currently paid either as subsidy or as wage payment (pay for work scheme, etc.) should be directly transferred to such account. Then the corruption at the lower level is eliminated and every person gets what exactly he / she is due.
- More effort should be made to open ATM's and bank branches in all the Mandals of the country. A 90-day programme should be prepared and the same should be implemented with strict guidelines.
- Laws of the country should be amended to ensure that the people violating the above—like physical possession of cash, payment / acceptance of cash beyond threshold limit—will be punished with in specified time limits—say maximum 6 months.

Benefits of the above :

1. Black money generation is totally suppressed.

2. Threat of fake currency generation in the economy is limited greatly.

3. One of the major issues which are having cascading effect on the Indian Economy for decades is insufficient income of agriculture. As a result, farmers are committing suicides as the revenue they are getting is quite insufficient to cover the cost of cultivation. As a result of this the farmers are not able to pay back the amounts they borrowed for cultivation. On getting into the grass route level of this problem, we can identify the reason as the exploitation by the middle-men who are procuring the agricultural produce at throwaway prices. So once the farmers are paid through electronic transfers / cheques by these middlemen, the government can have a better tracking to fix the prices. Later, when the government can review the income and expense of these middlemen, the exploitation can be identified and people involved can be suitably punished. Over a period of time, this will ensure proper and right price for agriculture, and the middlemen also will not dare to procure at abnormal low price since they are not allowed to have physical cash and all their income, too is tracked with PAN-linked Bank accounts. This will ultimately lead to healthy farmers, health agricultural produce and, obviously, healthy GDP.

4. Today Government of India is spending crores of rupees on the printing, maintenance and distribution of new currency every year. Once the government initiates the above steps, the need for physical currency in the country will come down drastically and, as a

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Test of Market Efficiency

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The Efficient Market Hypothesis (EMH) has been consented as one of the cornerstones of modern financial economics. We first defined the term ''efficient market'' in financial literature in 1965 as one in which security prices fully reflect all available information. The market is efficient if the reaction of market prices to new information should be instantaneous and unbiased. Efficient market hypothesis is the idea that information is quickly and efficiently incorporated into asset prices at any point in time, so that old information cannot be used to foretell future price movements. Consequently, three versions of EMH being distinguished depends on the level of available information.

The weak form EMH stipulates that current asset prices already reflected past price and volume information. The information contained in the past sequence of prices of a security is fully reflected in the current market price of that security. It is named weak form because the security prices are the most publicly and easily accessible pieces of information. It implies that no one should be able to outperform the market using something that ''everybody else knows''. Yet, there are still numbers of financial researchers who are studying the past stock price series and trading volume data in attempt to generate profit. This technique is so called technical analysis that is asserted by EMH as useless for predicting future price changes.

The semi strong form EMH states that all publicly available information is similarly already incorporated into asset prices. In other words, all publicly available information is fully reflected in a security's current market price. The public information stated not only past prices but also data reported in a company's financial statements, company's announcements, economic factors and others. It also implies that no one should be able to outperform the market using something that ''everybody else knows''. This indicates that a company's financial statements are of no help in forecasting future price movements and securing high investment returns.

The strong form EMH stipulates that private information, or insider information too, is quickly incorporated by market prices and, therefore, cannot be used to reap abnormal trading profits. Thus, all information, whether public or private, is fully reflected in a security's current market price. That means even the company's management (insider) are not able to make gains from inside information they hold. They are not able to take the advantages to profit from information such as takeover decision which has been made ten minutes ago. The rationale behind to support is that the market anticipates, in an unbiased manner, future development, and therefore, information has been incorporated and evaluated into market price in much more objective and informative way than insiders.

The random walk model of asset prices is an extension of the EMH, as are the notions that the market cannot be consistently beaten, arbitrage is impossible, and ''free lunches'' are generally unavailable. The runs test is a non-parametric statistical test that checks a randomness hypothesis for a two-valued data sequence. More precisely, it can be used to test the hypothesis that the elements of the sequence are mutually independent.

A ''run'' of a sequence is a maximal non-empty segment of the sequence consisting of adjacent equal elements. For example, the sequence ''++++——+++—++++++——'' consists of six runs, three of which consist of +s and the others of –s. If +s and –s alternate randomly, the number of runs in the sequence N for which it is given that there are N_+ occurrences of + and N– occurrences of – (so $N = N_+ + N_-$) is a random variable whose conditional distribution—given the observation of N_+ positive runs and N_- negative runs —is approximately normal with:

- mean
- variance $\mu\sigma^2 = \dfrac{2N_+N_-(2N_+N_- - N)}{N^2(N-1)} = \dfrac{(\mu-1)(\mu-2)}{N-1}$

These parameters do not depend on the ''fairness'' of the process generating the elements of the sequence in the sense that +s and –s must have equal probabilities, but only on the assumption that the elements are independent and identically distributed. If there are too many runs more or less than expected, the hypothesis of statistical independence of the elements may be rejected.

Runs tests can be used to test

1. the randomness of a distribution, by taking the data in the given order and marking with + the data greater than the median, and with - the data less than the median (Numbers equalling the median are omitted).
2. whether a function fits well to a data set, by marking the data exceeding the function value with + and the other data with –. For this use, the runs test, which takes into account the signs but not the distances, is complementary to the chi-square test, which takes into account the distances but not the signs.

Run test statistics is a kind of non-parametric statistical test that checks a randomness hypothesis for a two-valued data sequences. More precisely, run test can be used to test the hypothesis that the elements of the sequence are mutually independent one. A run of a sequence is defined as a maximal non-empty segment of the data sequence consisting of adjacent equal elements.

Mathematical Formulae

Run test can be used to perform

- Randomness of a distribution is found by taking the data in the given form or order and marking with + the data greater than the median and with – the data less than the median
- Numbers which equal the median get omitted.
- It checks whether a function fits well to a data set values, by marking the data exceeding the function value with + and the other data with –. It mainly depends on signs.
- If the number of runs falls outside the interval of $\mu \pm 1.46\sigma$ *(for this project only), universally accepted is* $\mu \pm 1.96$, then it is reasonable to reject the hypothesis and that the curve is a good description of the data.

$$\text{Mean} = \left(\frac{2(N_+)(N_-)}{N}\right) + 1$$

$$\text{Variance } \sigma^2 = \frac{2N_+ N_- 2N_+ N_- - N}{(N^2)(N-1)} = \frac{(\mu-1)(\mu-2)}{N-1}$$

where

$N = (N_+) + (N_-)$

N+ = positive runs or number of occurrences of +s

N– = negative runs or number of occurrences of –s

If the sample size is unequal and either η_1 and η_2 is larger than 20, or if the sample size is equal and larger than 100, then the test statistic is

$$z = \frac{r - \left(\frac{2\eta_1\eta_2}{\eta_1+\eta_2}\right) + 1}{\sqrt{\frac{(2\eta_1\eta_2(2\eta_1\eta_2 - \eta_1 - \eta_2))}{(\eta_1+\eta_2)^2(\eta_1+\eta_2-1)}}}$$

where r (test statistic) is the number of runs or average of the most and fewest runs

Objectives

1. To check whether successive price changes are independent or not during the given time period.
2. To check whether Indian capital markets are in weak form of efficiency, semi-strong form of efficiency, or strong from of efficiency.
3. To check whether prices get affected by demand and supply to reflect equilibrium position.
4. To prove whether Price change is Random or Not.

Hypothesis

Ho Null Hypothesis : Price change is random

Ha Alternate hypothesis : Price change is not random

Hypothesis was tested at 20 percent significance level at which 'Z' value is 1.28

Research Methodology

Type of study	: Empirical
Sample Design	: Judgmental
Sample 6 Leading Banks	: ICICI, HDFC, CANARA BOB,AXIS, SBI
Data Source	: Stock market quotations
Type of Data	: Secondary Data
Period of Data	: JAN. 2005 TO OCT. 2010 Monthly base

Research Plan

Scope of the study

The prices of the stocks are taken during calendar years Jan. 2005-Oct. 2010 spreading over Pre-recession, during Recession, and post-recession period.

Literature Review

Meredith Beechey, David, Gruen, James, Vickery. The efficient market hypothesis states that assets prices in financial market should effect all available information; as a consequence prices should always be consistent with fundamentals.

The paper discusses the main ideas behind the efficient market hypothesis and provided a guide as to which of its predictions seem to be borne out by empirical evidence and which do not. The evidence suggests that it cannot explain some important and worrying features of asset market behavior. Investors inconsistency, transaction cost and unavailable information may all be source of market inefficiency, study their impact, as well as the influences of other conditions, on the development of prices in the primary goal in the empirical literature.

(2005) Malkiel shows that professional investment managers do not out perform their index benchmarks and provides evidence that, by and large, market prices do seem to reflect all available information.

(2006) Toth and Kertesz found evidence of increasing efficiency in N.Y.S.E. by the theoretical and empirical studies of the efficient market hypothesis and have made an important contribution to the understanding of the stock market, and the present state of understanding is far from conclusive.

Are emerging financial markets efficient by Sardar M. N. Islam Sethapeng Watanapala-chaikul and Colin Clark (2005). Sanford Gross describes a model which shows that informational efficient price systems aggregates diverse information perfectly (1980).

Beja (1977) showed that the efficiency of a real market is impressible.

Le Roy (1981) and porter showed that stock markets exhibit excess volatility and they reflect market efficiency.

Lawrence H Summers (1986) argues that many statistical tests of market efficiency have very low power in discriminating against plausible forms of inefficiency.

Lo and Mackinley strongly rejected the random walk hypothesis for weekly stock returns show positive auto correlation over short period and negative auto correlation over longer horizons (1988).

Elroy Dimson and Massoud Mussavian give a brief history of market efficiency (1998).

Bernstein criticizes the EMH and Claims that the marginal benefits of investors acting on information exceed the marginal costs. Malkiel shows that professional investment managers do not outperform their index benchmarks and provides evidence that, by and large, market prices do seem to reflect all available information (2005).

Blakey looked at some of the causes and consequences of random price behavior (2006).

Toth and Kertesez found evidence of increasing of efficiency in New York Stock Exchange (2006).

Stileifer publishes inefficient markets; an introduction to behavioral finance, which questions the assumptions of investors' rationality and perfect arbitrage.

Monthly Stock Prices—6 BANKS

Date	ICICI	HDFC	Canara	BOB	Axis	SBI
Month	Close Price	Close Price	Close Price	Close Price	Close Price	Close Price
Jan-05	360.6	564.4	209.15	205.05	206.02	642.08
Feb-05	380.75	586.9	218.25	218.05	241.05	714.04
Mar-05	393.00	544.25	200.4	218.05	242.05	656.95
Apr-05	360.02	537.2	174.95	172.25	230.01	584.08
May-05	392.05	540.05	199.55	195.65	239.08	670.07
Jun-05	421.55	634.1	210.9	196.03	247.15	681.55
Jul-05	536.00	685.5	252.1	257.05	259.09	800.08
Aug-05	481.07	640.15	224.6	245.05	250.00	796.65
Sep-05	600.35	687.55	231.95	248.95	265.05	938.06
Oct-05	497.07	606	201.95	218.85	238.03	838.25
Nov-05	537.15	687.55	209.75	230.05	271.04	896.25
Dec-05	584.07	707.45	240.55	240.85	286.35	907.45
Jan-06	609.15	762.55	249.15	249.75	337.15	886.08
Feb-06	615.01	736.05	286.15	223.02	328.35	877.02
Mar-06	589.25	773.05	266.09	230.03	356.35	968.05
Apr-06	590.25	826.06	254.01	231.05	347.05	913.65
May-06	536.05	740.02	229.25	227.05	285.08	831.00
Jun-06	487.04	791.15	200.08	198.08	266.75	727.04
Jul-06	554.05	795.05	196.65	222.00	297.85	810.05
Aug-06	596.05	853.15	221.02	250.06	342.09	930.00
Sep-06	699.05	926.00	284.15	288.25	379.02	1028.03
Oct-06	776.85	1004.05	294.00	279.05	433.75	1095.05
Nov-06	871.45	1118.04	297.75	262.15	474.05	1314.00
Dec-06	890.04	1069.75	276.02	239.09	469.05	1245.09
Jan-07	940.05	1078.15	241.01	249.85	534.00	1138.05
Feb-07	831.09	932.06	210.05	219.75	460.00	1039.15
Mar-07	853.01	949.04	194.07	215.04	490.15	992.09
Apr-07	865.09	1026.15	217.65	235.95	467.85	1105.25
May-07	918.09	1139.75	244.02	275.02	579.55	1352.04
Jun-07	955.03	1144.01	269.65	270.25	605.00	1525.03
Jul-07	927.05	1198.65	261.75	299.95	626.07	1624.05
Aug-07	884.65	1171.03	244.00	267.06	634.01	1599.05
Sep-07	1063.15	1439.05	278.02	326.06	764.04	1950.07
Oct-07	1257.00	1653.01	292.95	342.35	918.08	2068.15
Nov-07	1184.65	1719.00	271.45	381.09	931.25	2300.03
Dec-07	1232.04	1727.08	332.05	459.06	967.01	2371.00
Jan-08	1145.65	1568.00	289.45	388.09	1110.08	2162.25
Feb-08	1090.95	1453.45	278.01	365.75	1018.75	2109.07
Mar-08	770.01	1319.95	225.02	283.09	781.15	1598.85
Apr-08	879.04	1514.85	237.01	315.15	924.03	1776.35
May-08	788.03	1357.85	216.00	270.05	794.05	1443.35
Jun-08	630.02	1002.03	178.00	203.25	603.65	1111.45
Jul-08	634.85	1095.25	183.75	255.05	653.85	1414.75
Aug-08	671.05	1277.25	215.05	284.03	723.03	1403.06
Sep-08	534.85	1229.00	188.75	297.55	720.05	1465.65
Oct-08	399.35	1023.65	165.25	241.07	562.06	1109.05
Nov-08	351.04	920.04	169.05	257.85	406.85	1086.85

(contd.)

(contd.)

Date	ICICI	HDFC	Canara	BOB	Axis	SBI
Month	Close Price	Close Price	Close Price	Close Price	Close Price	Close Price
Dec-08	448.35	997.06	187.08	280.45	504.65	1288.25
Jan-09	416.03	924.06	180.25	252.55	433.00	1152.02
Feb-09	328.01	884.85	165.35	220.04	347.95	1027.01
Mar-09	332.06	967.85	165.09	234.55	414.05	1066.55
Apr-09	477.75	1100.07	197.55	327.00	555.65	1277.07
May-09	740.07	1442.35	283.95	438.03	783.04	1869.01
Jun-09	722.00	1491.75	262.45	445.03	833.65	1742.05
Jul-09	759.05	1499.06	285.05	436.00	917.07	1814.00
Aug-09	749.05	1469.35	266.35	433.35	906.07	1743.05
Sep-09	904.08	1642.25	321.75	482.04	981.55	2195.07
Oct-09	789.06	1621.03	341.02	509.15	907.09	2191.00
Nov-09	864.03	1772.55	396.25	523.35	997.45	2238.15
Dec-09	875.07	1700.04	390.75	511.03	988.07	2269.45
Jan-10	830.04	1630.85	390.45	575.09	1025.05	2058.00
Feb-10	871.85	1704.65	391.95	583.09	1124.85	1975.85
Mar-10	952.07	1932.05	410.35	639.25	1169.01	2079.00
Apr-10	950.05	1991.06	429.55	691.55	1268.02	2297.95
May-10	867.05	1885.04	408.2	710.04	1228.04	2268.35
Jun-10	862.00	1914.65	448.85	701.95	1242.95	2302.01
Jul-10	904.45	2127.45	478.45	753.05	1345.04	2503.08
Aug-10	977.03	2132.45	514.00	804.09	1324.85	2764.85
Sep-10	1110.35	2480.08	582.65	872.08	1531.02	3233.02
Oct-10	1157.75	2493.65	585.01	903.75	1576.95	3256.35
Run test	70	70	70	70	70	70
Positve	43	46	39	43	45	40
Negative	27	24	31	27	25	30
Observed	32	33	29	32	35	35

$$\mu = \frac{2N1N2}{N1+n2} + 1$$

Interpretations

The Observed Runs fall between Lower and Upper Limits for ICICI BANK, HDFC BANK, CANANRA BANK, BOB, AXIS BANK AND SBI. (For CANARA BANK, there is small difference, which is negligible).

µ	34.17142857	32.54285714	35.54285714	34.17142857	33.14285714	35.28571429

$\sigma = \frac{\sqrt{2N1N2 * (2N1N2 - N1 - N2)}}{\sqrt{(N1N2)^{\wedge}2 * (N1 + N2 - 1)}}$	15.46626442	13.96244898	16.79226264	15.46626442	14.50754215	16.53948536
	3.9327	3.737	4.09784	3.933	3.808877	4.0668766
LIMIt	1.28					
Upper Limit	39.20530656	37.32575129	40.78808765	39.20530656	38.0182939	40.49131635
Lower Limit	29.13755058	27.759963	30.29762663	29.13755058	28.26749489	30.08011222
Observed	32	33	29	32	35	35

Conclusion

Observed limit is falling under upper and lower. So Null Hypothesis is accepted and supports the findings that Indian capital market is efficient in weak form, i.e. share prices move independently of each other during successive days. ❐

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result, it will lead to savings on currency printing, maintenance and distribution.

Mechanism to handle the current balckmoney in the system

Today, within India, crores of rupees are stashed below the underground lockers of politicians, businessmen and others. So the question arises as to how to handle the cash which is in the system either legally or illegally—within the country if the government decides to move with the above proposals.

It is suggested to follow the below-referred mechanisms for the same :

a. People having legal money : People should be given a month's time to deposit the cash in banks, or, maybe, three months. After three months, they should not be allowed to have a physical cash above Rs. 20,000 with them. It should be clearly communicated before the policy announcement that this money so deposited is subject to questioning and assessment by the concerned authorities.

b. To all individuals who have illegal money currently or those with unexplainable money, government should give an option to deposit the money in their account after paying a minimum 40% as one-time tax. Only, once the proof of tax payment is provided, the bank should accept the cash. Once this is done, then Government also witnesses huge taxation income which can used for the developmental works in the country.

So the execution of the above steps will lead to complete elimination of black money in the country as today and also this will stop the black money generation in the country in future. This leaves a question as to what happens to the black money which is already outside the country—once the persons are aware that they cannot bring this money outside the country at a later stage without punishment under the law, people will regularize the same currently by paying the proposed 40% one-time tax. ❐

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Members of the Quality Review Board of the Institute of Cost Accountants of India

The Quality Review Board has been reconstituted vide Notification number G.S.R. 69 (E) dated 6th February 2012. The Board now consists of the following members :

1. Shri R.S. Sharma, Ex-Chairman ONGC—Chairperson
2. Shri Navrang Saini, Regional Director, (Eastern Region), MCA—Member
3. Ms. Nandna Munshi, Principal Director of Commercial Audit & Ex-officio Member, Audit Board I—Member
4. Shri V. Kalyanaraman, Past President, ICAI—Member
5. Shri Kunal Banerjee, Past President, ICAI—Member

FOR ATTENTION OF MEMBERS
Benevolent Fund For the Members of The Institute

Objective

The Fund has been created to provide :

1. Outright grant of prescribed amount to the member in the event of critical illness of a member of the Fund.
2. Outright grant of prescribed amount to the beneficiary in the event of death of a member of the Fund.
3. Financial assistance of prescribed amount repayable in prescribed manner by the members of the Fund in case of financial distress due to prolonged illness or temporary loss of employment, illness of spouse / dependent children of member of the Fund; and education of dependent children of deceased member of the Fund.

Beneficiary means member of the Fund including dependent spouse / dependent children / parents / dependent minor brothers and sisters of the member of the Fund.

Procedure of Life Membership

An Associate / Fellow Member having paid up-to-date membership fees to the Institute can become a Life Member of the Fund on application being made in the prescribed application form along with a remittance of Rs. 2500 / -, (Rupees Two Thousand Five Hundred only) (one time payment) by cash or by cheque or demand draft payable at Kolkata drawn on scheduled bank in favour of ICAI Members' Benevolent Fund. In case of outstation cheque not payable at Kolkata, applicable bank charges are to be added. The application form can be collected from the headquarters of the Institute at Kolkata or downloaded from the website of the Institute www.icai.org. Soft copy of the application form can also be sent on requisition made to e-mail: membership.kb@icai.org .

For the purpose of obtaining benefit from the Fund, a member should ensure to pay his up-to-date Associate / Fellow membership fees to the Institute and his name should continue to exist in the Register of Members of the Institute.

Invitation for Empanelment of Resource Persons For Conducting Investors Awareness Programme

Institute of Cost Accountants of India invites Expression of Interest from Cost Accountants, Financial Market Experts, and Academicians having domain expertise in Financial Markets to act as Resource Person for conducting Investors Awareness Programme jointly organised by the Institute and Ministry of Corporate Affairs, Government of India, across the country. The Resource Persons so retained by the Institute will have to plan and organise such programmes of two hours duration in towns (other than District Head Quarters and State Capitals). Arranging venue, organizing at least 50 participants and delivering the financial literacy to the participants are some of the initiatives expected from the Resource Persons. For this initiative, maximum amount of Rs. 5000.00 (all inclusive) perprogramme will be reimbursed.

Interested Persons can file their expression of interest on-line by visiting Institute's web site www.icwai.org. or can send their detailed profile with a proposal indicating the towns where they could conduct the programme to the following address :

The Director (CAT)
The Institute of Cost and Accountants of India
CMA Bhawan
4th Floor
3- Institutional Area
Lodi Road
New Delhi 110003
Email: cat.rashmi@icwai.org

those who are already empanelled by the Institute for this purpose need not apply again.

THE INSTITUTE OF COST ACCOUNTANTS OF INDIA
CERTIFICATE COURSE
ON
INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS) & CONVERGED INDIAN ACCOUNTING STANDARDS

1. Bangalore — 27 June – 1 July, 2012	3. Hyderabad -18-22 July, 2012
2. Kolkata — 22-26 August, 2012	4. Delhi - 26-30 September, 2012
5. Mumbai — 26-30 December, 2012	

Course Objective

India has taken a big initiative for IFRS Convergence which originally scheduled to be effective from 1st April, 2011, now deferred by Ministry of Corporate Affairs, Government of India for some more time. The government has already notified partial converged of Indian Accounting Standards (Ind-AS). The Institute of Cost Accountants Certificate Course offers an excellent opportunity to learn IFRS and converged Indian Accounting Standards through distance learning mode that includes in-depth personal interaction sessions with expert faculty.

The course aims to help the participants to understand IFRS convergence and thereby enabling them to participate in IFRS convergence process

Course Coverage

Financial Statements - Revised Schedule VI	Service Concession Arrangements
Property, Plant and Equipment (PPE)	Operating Segment
Intangible Assets	Financial Instruments
Lease Accounting	Disclosures of Financial Instruments
Investment Property	Provisions, Contingent Liabilities and contingent Asset
Non-Current Assets held for Sale and Discontinued Operations	Consolidation
Related Party disclosures	Share Based Payment
Revenue Recognition	Business Combinations
Construction Contracts	IFRS Conversion

Duration

Two months including five days classroom session with case studies followed by on-line practice and on-line examination.

For Whom

Cost Accountants, Chartered Accountants and Company Secretaries, Senior and Middle level executives of various Public and Private Sector organizations, Banks, financial Institutions, Insurance Companies, Government departments, Autonomous bodies, Statutory Bodies, Multinationals, etc.; Practicing Cost Accountants, Company Secretaries and Chartered Accountants, Faculty of Universities, Management Institutions and Autonomous professional Institutions, Students pursuing the professional courses and any other person involved in the IFRS process.

Methodology

- Class room sessions of 40 Hrs. (Wednesday-Sunday from 10.00 AM to 6.00 PM)
- Course Material
- Large Question Bank with facilities to practice
- Online Examination

Course Fee :

Rs. 25000/- plus 12.36% service tax per participant. The Fee includes faculty fee, course kit including specialised course material, hall charges, lunch, tea/coffee and online assignment and Examination charges. (15% discount on the Fee for the Practicing Members and Students of The Institute of Cost Accountants of India)

The Payment of the Fee is to be made by cheque/DD in favour of `The Institute of Cost Accountants of India' payable at New Delhi along with the application/nomination

Details of ECS Payment : State Bank of India (60321), Andhra Association Building,24-25 Institutional Area, Lodhi Road , New Delhi - 110 003.

Current A/c No. : 30678404793 MICR Code : 110002493 IFSC Code : SBIN0060321

For Registration and Further Details Please Contact

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Website : www.mdp.icwai.org, www.icwai.org

Request For Comments

Cost Accounting Standards Board, the standard-setting body of the Institute, had approved the release of Exposure Draft of Revised Cost Accounting Standard - 2 on Capacity Determination (CAS - 2). The CASB Secretariat issued the same in February 2012 for public comments and a number of comments were received on the Exposure Draft. In the 52nd meeting of the Board, held on 16th April 2012, the Board discussed the comments and in the light of the comments, it was decided to make certain changes in the Exposure Draft. The revised exposure draft is again being hosted on the website for comments.

The revised Exposure Draft may be modified in light of comments received before being issued as a standard in final form.

Please submit your views/comments/suggestions on the proposed revised Exposure Draft, preferably by email, latest by 31st May 2012.

Comments should be addressed to :
The Secretary,
Cost Accounting Standards Board,
CMA Bhawan, 3rd Floor
The Institute of Cost Accountants of India,
3, Institutional Area, Lodi Road
New Delhi - 110003

Emailed responses should be sent to: casb@icwai.org
Copies of this revised Exposure Draft may be downloaded from the CASB website at http://www.casbicwai.org

CEP Directorate of the Institutes is Organising Following Programmes during 23-26 May 2012 at Gangtok

(I) Contracts and their Management

Name of the Programme	Contracts and their Management
Course Contents	• Negotiation Skills & Techniques • Contracts—Concepts and Legal Issues • Contracts and their Management • Flaws in Contracts • Case Studies (Liquidated Damages; Bank Guarantees; Arbitration; Foreign Award) • CVC Guidelines
Venue	(GANGTOK, SIKKIM) Hotel The Royal Plaza, Upper Syari, Deorali, Gangtok, Sikkim 737 102. Tel : 91 35922 80232 Fax : 91 35922 81112
Course Director	Mr. BS Ramaswamy Cost Accountant & Former Addl. Secty., Govt. of India (Author of the Book on 'Contracts & their Management' published by Lexis Nexis Butterworths)
Date	23 - 26 May 2012 Check-in —12.00 Hrs. on 23rd May 2012 Check-out—12.00 Hrs. on 25th May 2012
Participation Fee	Rs. 35,000/- plus applicable service tax per participant. (Fee includes course fee, course material, accommodation on single room basis, all meals and visits) (the charge for accompanying Spouse would be Rs. 1,000/- (Rupees one thousand only) for all the three days. THE CHEQUE/DD to be sent along with nominations in favour of ''The Institute of Cost Accountants of India'' payable at New Delhi. Details of ECS Payment : State Bank of India (60321), Andhra Association Building, Institutional Area, Lodi Road, New Delhi 110 003. Current Accont No. : 30678404793 MICR CODE : 110002493, IFSC CODE : SBIN0060321
Registration	CMA D Chandru Director (CEP), The Institute of Cost Accountants of India CMA Bhawan, 3rd Floor, 3 Institutional Area, Lodhi Road, New Delhi 110 003. Tel : 2464 3273, e-mail : mdp@icwai.org, cep.chandru@icwai.org Website: www.mdp.icwai.org , www.icwai.org,

(II) Recent Trends in Corporate Reporting including IFRS and Revised Schedule VI

Name of the Programme	Recent Trends in Corporate Reporting including IFRS and Revised Schedule VI
Course Contents	• Presentation of Financial Statements • Presentation of Balance Sheet • Presentation of Statement of Profit and Loss • IFRS and Fair Value Measurement • Derivatives Accounting • Development in Insurance Accounting • Impairment Analysis • Non-current Assets held for Sale and Discontinued Operations • Agriculture • Investment Property
Venue	(GANGTOK, SIKKIM) Hotel The Royal Plaza, Upper Syari, Deorali, Gangtok, Sikkim 737 102. Tel - 91 35922 80232 Fax : 91 35922 81112
Course Director	Dr. TP Ghosh, Professor, IMT Dubai
Date	23 - 26 May 2012 Check-in —12.00 Hrs. on 23rd May 2012 Check-out —12.00 Hrs. on 25th May 2012
Participation Fee	Rs. 35,000/- plus applicable service tax per participant. (Fee includes course fee, course material, accommodation on single room basis, all meals and visits) (the charge for accompanying Spouse would be Rs. 1,000/- (Rupees one thousand only) for all the three days. THE CHEQUE/DD to be sent along with nominations in favour of ''The Institute of Cost Accountants of India'' payable at New Delhi. Details of ECS Payment : State Bank of India (60321), Andhra Association Building, Institutional Area, Lodi Road, New Delhi 110 003. Current Accont No. : 30678404793 MICR CODE : 110002493, IFSC CODE : SBIN0060321
Registration	CMA D Chandru Director (CEP), The Institute of Cost Accountants of India CMA Bhawan, 3rd Floor, 3 Institutional Area, Lodhi Road, New Delhi 110 003. Tel : 2464 3273, e-mail : mdp@icwai.org, cep.chandru@icwai.org Website: www.mdp.icwai.org , www.icwai.org,

Guidelines For Conversion of Cost Accountants' Firms

(Partnership/Proprietary)

Into Limited Liability Partnerships (LLPS)

In terms of Council decision dated 22nd January, 2012, the following guidelines for conversion of Cost Accountants firms into LLPs and constitution of separate LLPs by the practising Cost Accountants have been finalized. They are applicable for conversion of Cost Accountants' firms into LLPs or formation of new LLPs, by the members in practice of the Institute of Cost Accountants of India (ICAI) upon coming into force the provisions of the Cost and Works Accountants (Amendment) Act, 2011 (i.e. 1st February, 2012), subject to the provisions of the Limited Liability Partnership (LLP) Act, 2008 and Rules & Regulations framed thereunder :

(A) Conversion of Cost Accountant firms into LLPs

1. All the existing Cost Accountants' firms who want to convert themselves into LLPs are required to follow the provisions of Chapter-X of the LLP Act, 2008 read with Second Schedule to the said Act containing provisions of conversion from existing firms into LLP.
2. In terms of Rule 18(2) (xvi) of LLP Rules- 2009, if the proposed name of LLP includes the words 'Cost Accountant' or 'Cost Accountants', as the case may be, as part of the proposed name, the same shall be referred to ICAI by the Registrar of LLP and it shall be allowed by the Registrar only if the Secretary / Authorized Official of ICAI * approves it.
3. If the proposed name of LLP of Cost Accountant firm resembles with any other non- Cost Accountant entity, as per the naming Guidelines under LLP Act and its Rules, the proposed name of LLP of Cost Accountant firm may include the word 'Cost Accountant' or 'Cost Accountants', as the case may be in the name of the LLP itself and the Registrar LLP may allow the same name, subject to compliance to Rule 18(2) (xvi) of LLP Rules as referred above.
4. For the purpose of registration of LLP with ICAI under Regulation 108 of the Institute of Cost and Works Accountants Regulations, 1959, the partners of the firm shall apply, in ICAI Form of Application for Particulars of Offices and Firms, along with the copy of name registration, received from the Registrar of LLP and submit the same with the concerned Office of ICAI. The Form shall contain all the details of the offices and other particulars as called for, together with the signatures of all partners or authorized partner of the proposed LLP.
5. The names of the Cost Accountant firms registered with ICAI shall remain reserved for the partners, as one of the options for LLP names, subject to the provisions of LLP Act & Rules and Regulations framed there under.
6. The following guidelines relating to seniority and other criteria shall be followed for registration of LLP with ICAI:
   - (i) Where two similar or identical or nearly similar firm names (whether the partners of such firms are same or not) have applied for registration to ICAI, under the proposed LLP, only one such firm name who applied first shall be approved and remaining firm who has applied with ICAI, whether desires to convert into LLP or not, will have to change the firm name.
   - (ii) The name of the LLP may be like 'X & Co. LLP' or 'X & Associates LLP' or 'XYZ LLP' and no other suffix shall be approved and registered by ICAI.
   - (iii) The newly converted Cost Accountant LLP registered with ICAI shall be allowed to work only in terms of Section 2(2) of the Institute of Cost and Works Accountants Act, 1959 and

for the objects of LLP to be incorporated as per Form-2 and Form 17 of the LLP Rules, 2009 or as per the LLP agreement and same shall be in the nature of Professional Services allowed under Section 2(2) of Cost and Works Accountants Act, 1959. LLP shall be subject to the same regulations, as if they were a partnership firm. Mere conversion into LLP does not give any privileges, which were not earlier with the Cost Accountant firms.

(iv) Inter se seniority among the firms shall be given to LLP as per the existing policy of ICAI. In other words, LLPs shall carry the same seniority, as the firm shall otherwise have under the existing policy of ICAI. In case of merger of 2 LLPs, same rules are applicable as to firms merging shall apply.

(v) The non converted firms shall also remain on the same position of seniority in relation to converted LLPs, as the converted LLPs shall have the same inter-se seniority, as the firms had earlier to conversion.

7. These guidelines of conversion of Cost Accountant firms into LLP shall also be applicable to the conversion of proprietary firm into LLP, subject to the provisions of LLP Act & Rules and Regulations framed there under. The conversion of proprietary firm shall be by way of incorporation of new LLPs.

8. The registration number (with minimum 6 numbers) of LLP with ICAI, shall be the same Firm Registration Number (FRN) allotted to the firm before the conversion by ICAI, with the Regional Code like 'W' for Western, 'E' for Eastern, 'S' for Southern, 'N' for Northern.

9. Introduction of LLP, shall not affect the existing regulations in force as regards the name allotment to Cost Accountant firms.

10. The provisions of the Cost and Works Accountants Act, 1959, the Cost and Works Accountants Regulations, 1959 and Code of Ethics issued by ICAI shall be applicable to all partners jointly & severally, of the converted Cost Accountant firms into LLP.

11. The following Guidelines are subject to the clarification from Ministry of Corporate Affairs (MCA), Government of India, New Delhi:

(i) Wherever the existing partnership firm has been appointed as statutory auditor of any company, after following the due procedure under the Companies Act, 1956 and the said firm with the same partners is converted into / has formed LLP, then the same FRN will continue band the Board of Directors of the Company shall take on record the conversion / formation of the Cost Accountant firms into LLP and the n ew LLP shall be deemed to be the Auditor of the said company, for the said financial year, in terms of Section 58(4) of the LLP Act, 2008.

(ii) Wherever more than one partnership firm, with all the partners, desire to convert / form only one LLP, then in that case the name and FRN may be selected of only one of such firms, for the purpose of registration with ICAI and;

(a) The other such firms shall stand dissolved.

(b) Seniority shall be decided as per applicable rules of ICAI.

(c) The Board of Directors of all the Companies, who have appointed all the erstwhile firms as Cost auditors, may take a declaration from the said LLP, with all the partners of all the erstwhile firms on record and the appointment as Cost auditors of all the erstwhile firms made under the Companies Act, 1956, shall be deemed to be in the name of the said LLP.

(B) Constitution of separate LLPs

12. All the members of ICAI in practice who want to constitute a separate LLP are required to follow the provisions of the LLP Act, 2008 read with the Rules framed there under.

13. In terms of Rule 18(2) (xvi) of LLP Rules- 2009, if the proposed name of LLP includes the words

'Cost Accountant' or 'Cost Accountants', as the case may be, as part of the proposed name, the same shall be referred to ICAI by Registrar of LLP and it shall be allowed by the Registrar only if the Secretary/Authorized Official of ICAI * approves it.

14. If the proposed name of LLP of Cost Accountant firm resembles with any other non-Cost Accountant entity, as per the naming Guidelines under LLP Act and its Rules, the proposed name of LLP of Cost Accountant firm may include the word 'Cost Accountant' or 'Cost Accountants', as the case may be in the name of the LLP itself and the Registrar LLP may allow the same name, subject to compliance to Rule 18(2) (xvi) of LLP Rules as referred above.

15. For the purpose of registration of LLP with ICAI under regulation 108 of the Cost and Works Accountants Regulations, 1959, the partners of the firm shall apply in the ICAI Form of Application for Particulars of Offices and Firms along with the copy of name registration, received from the Registrar of LLP and submit the same with the concerned Office of the ICAI. This Form shall contain all details of the offices and other particulars as called for together with the signatures of all partners or authorized partner of the proposed LLP.

16. The following guidelines relating to seniority and other criteria shall be followed for registration of LLP with ICAI:

 (i) Where two similar or identical or nearly similar firm names (whether the partners of such firms are same or not) have applied for registration to ICAI, under the proposed LLP, only one such firm name who applied first shall be approved and remaining firm who has applied with ICAI, whether desires to convert into LLP or not, will have to change the firm name.

 (ii) The name of the LLP may be like 'X & Co. LLP' or 'X & Associates LLP' or 'XYZ LLP' and no other suffix shall be approved and registered by ICAI.

 (iii) The newly converted Cost Accountant LLP registered with ICAI shall be allowed to work only in terms of Section 2(2) of the Institute of Cost and Works Accountants Act, 1959 and for the objects of LLP to be incorporated as per Form-2 and Form 17 of the LLP Rules, 2009 or as per the LLP agreement and same shall be in the nature of Professional Services allowed under Section 2(2) of Cost and Works Accountants Act, 1959. LLP shall be subject to the same regulations, as if they were a partnership firm. Mere conversion into LLP does not give any privileges, which were not earlier with the Cost Accountant firms.

 (iv) Inter se seniority among the firms shall be given to LLP as per the existing policy of ICAI. In other words, LLPs shall carry the same seniority, as the firm shall otherwise have under the existing policy of ICAI. In case of merger of 2 LLPs, same rules are applicable as to firms merging shall apply.

 (v) The non converted firms shall also remain on the same position of seniority in relation to converted LLPs, as the converted LLPs shall have the same inter-se seniority, as the firms had earlier to conversion.

17. These guidelines of conversion of Cost Accountant firms into LLP shall also be applicable to the conversion of proprietary firm into LLP subject to the provisions of LLP Act, Rules and Regulations framed there under. The conversion of proprietary firm shall be by way of incor-poration of new LLPs.

18. The registration number (with minimum 6 numbers) of LLP with ICAI, shall be like the Firm Registration Number being allotted to the firms by ICAI with the Regional Code like 'W' for Western, 'E' for Eastern, 'S' for Southern, 'N' for Northern.

19. Introduction of LLP, shall not affect the existing regulations in force as regards Name allotment to Cost Accountant firms.

20. The provisions of the Cost and Works Accountants Act, 1959, the Cost and Works Accountants Regulations, 1959 and Code of Ethics issued by ICAI shall be applicable to all partners jointly and severally, of the LLP.
21. In case of any dispute in respect of these guidelines, the same shall be referred to the Council of ICAI and the decision of the Council shall be final and binding on the members of the Institute.
22. For the purpose of any clarification regarding the approval and registration of proposed LLP with ICAI, the requests can be sent at the following address:

Shri Kaushik Banerjee
Director & Joint Secretary
The Institute of Cost Accountants of India
12, Sudder Street,
Kolkata - 700 016.
(*Shri Kaushik Banerjee, Director & Joint Secretary is the Authorized Official of ICAI)

23. These Guidelines shall come into force w.e.f. 1st February, 2012.

For Attention of Members

The provisions of The Cost and Works Accountants (Amendment) Act, 2011 have come into force with effect from 1st February, 2012, whereby the name of our Institute has been changed from The Institute of Cost and Works Accountants of India to "The Institute of Cost Accountants of India" and the Associate & Fellow Members of the Institute are now entitled to use the letters **"ACMA"** & **"FCMA"** after their names in place of "AICWA" & "FICWA" respectively.

Further, the practising members of our Institute can now enter into a Limited Liability Partnership, which has no company as its partner in accordance with the Limited Liability Partnership Act, 2008. In this connection, the two notifications published by the Central Government in the Gazette of India dated 13th January, 2012 and 30th January, 2012 are printed in this journal.

Further details are published in this journal and also uploaded on our website www.icwai.org .

For Attention of Members

The Council of the Institute has decided that the members of the Institute shall be permitted to use the letters "CMA" before their names after notification regarding the date of coming into force of the provisions of the Cost and Works Accountants (Amendment) Act, 2011 is published by the Central Government in the Gazette of India, wherein the Associate & Fellow Members are entitled to use the letters **"ACMA"** & **"FCMA"** respectively after their names.

THE INSTITUTE OF COST ACCOUNTANTS OF INDIA

(Statutory Body Under An Act of Parliament)

Examination Time Table & Programme – June 2012

Certificate in Accounting Technicians (CAT)

Day & Date	Time	Competency Level Part - II
Monday, 11th June 2012	09.30 A.M. to 12.30 P.M.	Financial Accounting
Wednesday, 13th June 2012	09.30 A.M. to 12.30 P.M.	Applied Statutory Compliance

Examination Fees

INLAND CENTRES	Competency Level Part – II	₹ 730/-

1. Application Forms for CAT Examination can be down loaded from Institute's website **www.icwai.org** and filed **online** also.
2. Last date of receipt of Examination Application Forms without late fee is **10th April, 2012** and with late fee of ₹100/- is **20th April, 2012**.
3. Examination Fees to be paid through Bank Draft of requisite fees drawn in favour of "**The Institute of Cost Accountants of India**" payable at **New Delhi**.
4. Students will send their Examination Application Forms along with the fees to Directorate of CAT at "CMA Bhawan", 3, Institutional Area, Lodi Road, New Delhi – 110003.
5. Examination Centres : Agartala, Ahmedabad, Akurdi, Allahabad, Alwar (Rajasthan), Asansol, Aurangabad, Bangalore, Baroda, Berhampur(Ganjam), Bhilai, Bhopal, Bhubaneswar, Bilaspur, Bokaro, Calicut, Chandigarh, Chennai, Coimbatore, Cuttack, Dehradun, Delhi, Dhanbad, Durgapur, Ernakulam, Faridabad, Ghaziabad, Guwahati, Hardwar, Howrah, Hyderabad, Indore, Jaipur, Jabalpur, Jalandhar, Jammu, Jamshedpur, Jodhpur, Kalyan, Kannur, Kanpur, Kolhapur, Kolkata, Kota, Kottayam, Lucknow, Ludhiana, Madurai, Mangalore, Mumbai, Mysore, Nagpur, Naihati, Nasik, Nellore, Neyveli, Noida, Palampur (H.P.), Panaji (Goa), Patiala, Patna, Pondicherry, Pune, Rajahmundry, Ranchi, Raigarh(Chattisgarh), Rourkela, Salem, Shillong, Solapur, Srinagar, Surat, Sahajahanpur, Thrissur, Tiruchirapalli, Tirunelveli, Trivandrum, Udaipur, Vapi, Vashi, Vellore, Vijayawada, Vindhyanagar, and Waltair.
6. A candidate who is fulfilling all conditions will only be allowed to appear for examination.
7. Probable date of publication of result: Competency Level Part – II is 22nd August, 2012.

C. Bose
Sr. Director (Examinations)

Examination — June 2012

THE INSTITUTE OF COST ACCOUNTANTS OF INDIA

(Statutory Body Under An Act of Parliament)

Examination Time Table & Programme – June 2012

Programme for Syllabus 2008

Day, Date & Time	Intermediate 09.30 A.M. to 12.30 P.M.	Final 02.00 P.M. to 05.00 P.M.	Foundation 02.00 P.M. to 05.00 P.M.
Monday 11th June, 2012	Financial Accounting	Capital Market Analysis & Corporate Laws	
Tuesday 12th June, 2012	———	Financial Management & International Finance	
Wednesday 13th June, 2012	Commercial and Industrial Laws & Auditing	Management Accounting– Strategic Management	
Thursday 14th June, 2012	Applied Direct Taxation	Indirect & Direct– Tax Management	
Friday 15th June, 2012	Cost & Management Accounting	Management Accounting– Enterprise Performance Management	Organisation and Management Fundamentals
Saturday 16th June, 2012	———	Advanced Financial Accounting & Reporting	Accounting
Sunday 17th June, 2012	Operation Management and Information Systems	Cost Audit & Operational Audit	Economics and Business Fundamentals
Monday 18th June, 2012	Applied Indirect Taxation	Business Valuation Management	Business Mathematics and Statistics Fundamentals

Examination Fees

Group (s)	Final Examination	Intermediate Examination	Foundation Course Examination
One Group (Inland Centres) (Overseas Centres)	₹ 1250/- US $ 100	₹ 1000/- US $ 90	₹ 1000/- US $ 60
Two Groups (Inland Centres) (Overseas Centres)	₹ 2250/- US $ 100	Rs. 1600/- US $ 90	

1. (a) Application Forms for Foundation Course, Intermediate and Final Examinations are available from Institute's Headquarters at 12, Sudder Street, Kolkata, Regional Councils and Chapters of the Institute on payment of ₹50/- per form. In case of overseas candidates, forms are available at Institute's Headquarters only on payment of US $ 10 per form.
   (b) Students can also download the Examination Form from ICAI Website at www.icwai.org. In case of downloaded form ₹ 50/- should be added extra towards the cost of the form.
   (c) Students can also submit the form online.
2. **Last datefor receipt of Examination Application Forms without late fees is 10th April, 2012** and with late fees of **₹300/-** is **20th April, 2012**.
3. Examination fees to be paid through **Bank Demand Draft** of requisite fees drawn in favour of **"The Institute of Cost Accountants of India"** and payable at Kolkata.
4. Students may submit their Examination Application Forms along with the fees at ICAI, 12 Sudder Street, Kolkata – 700016 or Regional Offices or Chapter Offices. Any query can be sent to Sr. Director (Examination) at H.Q.
5. **Finance Act 2011, involving Assessment Year 2012-2013 will be applicable for the subjects Applied Direct Taxation (Intermediate), Applied Indirect Taxation (Intermediate) and Indirect & Direct – Tax Management (Final) for the purpose of June 2012 term of Examination under Revised Syllabus 2008**.
6. **Examination Centres:** Agartala, Ahmedabad, Akurdi, Allahabad, Asansol, Aurangabad, Bangalore, Baroda, Berhampur(Ganjam), Bhilai, Bhopal, Bhubaneswar, Bilaspur, Bokaro, Calicut, Chandigarh, Chennai, Coimbatore, Cuttack, Dehradun, Delhi, Dhanbad, Durgapur, Ernakulam, Faridabad, Ghaziabad, Guwahati, Hardwar, Howrah, Hyderabad, Indore, Jaipur, Jabbalpur, Jalandhar, Jammu, Jamshedpur, Jodhpur, Kalyan, Kannur, Kanpur, Kolhapur, Kolkata, Kota, Kottayam, Lucknow, Ludhiana, Madurai, Mangalore, Mumbai, Mysore, Nagpur, Naihati, Nasik, Nellore, Neyveli, Noida, Panaji (Goa), Patiala, Patna, Pondicherry, Pune, Rajahmundry, Ranchi, Rourkela, Salem, Shillong, Solapur, Surat, Thrissur, Tiruchirapalli, Tirunelveli, Trivandrum, Udaipur, Vapi, Vashi, Vellore, Vijayawada, Vindhyanagar, Waltair and Overseas Centres at Dubai and Muscat.
7. **A candidate who is completing all conditions will only be allowed to appear for examination**.
8. **Probable date of publication of result : Foundation – 2nd August 2012 and Inter & Final – 22nd August 2012.**

C. Bose
Sr. Director (Examinations)

REGIONS & CHAPTERS NEWS

WIRC

Navi Mumbai Chapter of Cost Accountants

On 6th April 2012, Shri M. Gopalakrishnan, President of the Institute visited Navi Mumbai Chapter along with Vice President Shri Rakesh Singh and Council Members Shri A.S. Durga Prasad, and Smt. Aruna Soman. Shri Vivek Bhalerao, Chairman of the Chapter, Shri G. K. Das Secretary of the Chapter and others greeted the dignitaries.

There was an informal exchange of information between the dignitaries and the Chapter representatives. The President gave updates about various initiatives of the Institute. Shri Vivek Bhalerao congratulated the President for some initiatives taken by the IT Directorate (like IEPS) and the Studies Directorate - sending the study material directly to the students through our Logistics Associate.

The meeting concluded with an informal note of thanks. The President's visit rejuvenated the members.

Vapi-Daman-Silvassa Chapter of Cost Accountants (VDSCCA)

A program was organized on 29th March 2012 to inaugurate VDSCCA and a seminar was held on that day on 'Cost Management & Budget Changes' at Lions Upasana Auditorium, Gunjan, Vapi. The Chapter was inaugurated by Shri M. Gopalakrishnan, President of the Institute who also released the souvenir on the occasion. Also present were Shri Rakesh Singh, Vice president of the Institute, Shri Vijay P. Joshi, Chairman, WIRC, Shri B.F. Modi, Chairman of the Chapter, Taxation expert Shri V.S. Datey and other distinguished guests.

Shri Rakesh Singh discussed the salient features of the recent provisions on Cost Audit & Cost Compliance, highlighting the practical applications. Shri V.S. Datey made a crticial analysis of 'Budget Changes and EA-2000'. There was an open forum where the members deliberated and discussed the above provisions.

SIRC

Hyderabad Chapter of Cost Accountants (HCCA)

Coal India Limited has conducted Campus Interviews for fresh Grad CMAs at Hyderabad Centre of Excellence, Gachhibowli, Hyderabad on 15th March, 2012. Shri B. Kumar, Associate Advisor of Hyderabad Centre of Excellence, Shri K.Ch.A.V.S.N. Murthy, past Chairman-SIRC and A. Vijay Kiran, Chairman-Students Services & Library extended their support in organizing this programme. A total of 32 candidates were selected out of 37 candidates attended the interviews.

Vishakhapatnam Chapter of Cost Accountants (VCCA)

VCCA organized a talk on 'Budget 2012' at hotel Dasapalla, Vishakapatnam on 25th March 2012. Shri S.S. N. Raju, Special Public Prosecutor, CID was the Chief Guest. Shri A. Chandrasekhar, Partner of SARC & Associates, Shri S. Satyananda Rao, Chairman, VCCA, Shri D. Ramana Murthy, Secretary, VCCA, Shri K. Sanyasi Rao, RCM of SIRC, Shri V.S.N. Murthy, expert on Direct Taxes, and Shri G. Prabhakar Shastry, expert on Indirect Taxation were the speakers on the said topic.

Shri S.S.N. Raju spoke on the growing importance of the Cost Accountants in Indian economy. He spoke about the financial frauds that are being committed in the corporate sector and the role of Cost accountants in curbing such fraud. Shri A. Chandra Sekhar discussed the salient features of the Budget stating that the welcome features were promises to curb black money and emphasis on infrastructure. Shri V.S.N. Murthy, expert on Direct Taxes, and Shri G. Prabhakar Shastry, expert on Indirect Taxation highlighted the provisions and the impact of direct and the indirect taxes.

The programme ended with a vote of thanks by Shri U. Prakash, Vice Chairman of the Chapter.

EIRC

Durgapur Chapter of Cost Accountants (DCCA)

DCCA organized ''Regional Cost Conference -2012'' on the theme ''Inclusive Growth through Industry & Infrastructure'' on 24th and 25th March 2012 at CMERI Auditorium, Durgapur.

The Chief Guest was Shri Basudeb Banerjee, IAS, Secretary; Ministry of Commerce & Industries Govt. of West Bengal who inaugurated the Conference by lighting the ceremonial lamp.

In the Inaugural session, Shri M. Gopalakrishnan, President and Sri Rakesh Singh Vice president of the Institute addressed the audience by explaining about various activities of the Institute, its members and the role they can play towards the development of the Indian economy through inclusive growth of industry and infrastructure.

Shri P. K. Bajaj, CEO, Durgapur Steel Plant, SAIL the Guest of Honour, in his address, emphasized that inclusive growth is a prerequisite to the development of the industry and economy. Shri Sugata Marjit, Chairman, West Bengal Council of Higher Education, Member, State planning Board, Govt. of West Bengal delivered the keynote address. He emphasized the need for professional approach regarding progress and prosperity of West Bengal through meaningful interaction between the Institute and Govt. of West Bengal.

Shri Amal Das, Shri Kunal Banerjee and Shri Shyamal Banerjee, past Presidents of the Institute, Dr Sanjiban Bandyopadhyaya, Shri S.C. Mohanty and Shri T.C.A. Srinivasa Prasad, Council Members, Shri Saswata Dasgupta, Chairman, EIRC, and other RCM's were present in the conference.

Howrah Chapter of Cost Accountants (HCCA)

HCCA organized a discussion on 'Union Budget 2012' on 18th March 2012 at the Chapter premises. Eminent Tax practitioner, Shri Sanjoy Bhattacharyya, Chartered Accountant was the main speaker. Shri Tapas Kumar Kanrar. Chairman of the Chapter welcomed the members and conducted the session. Many members from and around Howrah participated in the discussion.

NIRC

Noida Chapter of Cost Accountants (NCCA)

NCCA organized a seminar on 'Union Budget 2012' on 19th March 2012 at NMA House, Noida. The programme was organised jointly in association with Noida Management Association (NMA) & Noida Chapter of Institute of Company Secretaries of India & IMS Noida. Shri Sunil Tandon, Vice President of NMA welcomed the delegates and spoke about the need for critical analysis of various budget proposals to understand their implications.

Leading direct and indirect tax experts were invited as speakers for detailed analysis of various tax proposals in the Budget. Shri Nabin Ballodia, Partner KPMG, one of the four top global consulting and audit firms spoke about various direct tax proposals. Shri J.K. Mittal, Advocate and well known expert in the field of service tax, spoke about service tax provisions.

Shri Lakshmi Narsimhan, Partner of Lakshmikuman & Sridharan, India's leading indirect tax law firm, presented critical analysis of excise and customs provisions.

Shri Suraj Prakash Chairman, of the Chapter summed up the proceedings beautifully. A lot of interesting questions were raised by members and other participants who came from various corporate houses like Jaypee group, BHEL, GAIL, IOCL, Kribhco, DMRC and other public and private sector companies. Shri Rajiv Bajaj, Chairman NIRC of ICSI graced the event with his presence. The proceedings of the programme were conducted by Shri R Venkataramanan, Vice Chairman of Noida Chapter.

Dear Sir,

Since couple of months lot of changes have been taking place in our Journal 'The Management Accountant' with respect to colour printing, quality improvement etc. The journal has passed a long Journey since started under the editorship of Late Shri T. S. Grewal an Eminent Accounting Academician of South Asia. I myself started reading this from 1991 and since then, I missed very few editions. Today I am trying to recap from my memory to summarize as a member/reader certain points which were long overdue. I think this will be helpful in increasing the image of the Institute, members and its Journal.

1. Economic Outlook on particular Industry/ Service and a general note on overall economic outlook of the country should always be a part of every month's edition. Arrangement should be made with Yojana/ CMIE/Any Financial Newspaper or thru in-house working group of the Institute for this purpose.

2. Prior to publication of industry specific Journal we should have at least arrangement with respective division of CII /FICCI and Ministry related to that Industry. This will help us in giving recognition, intellectual support and patronage for any future projects of the respective industry. The PRO of the Institute should try to get at least some review or comments of respective bodies of Chambers of Commerce/Ministry etc in industry specific editions.

3. An interview with CEO /VP of a Market Leader or a dominant player . Say, an interview of some Executives from Wal-mart may be taken by in house team.

4. Challenges, Scope, Opportunities for CMAs in that particular Industry and article on industry specific subject can be invited.

5. Article on new developments in Information Technology should be a regular feature. Also, articles on Health/Yoga/Ergonomics/Soft Skills/IT tools like Access/Excel/Outlook /ERP/ smart applications and commands should come regularly on periodic basis.

6. The review on new releases of books on Management, Economics, Business, Finance should be a regular feature.

7. Online Edition to be changed from PDF to Book Reader - nowadays most of our members use Tablets, E-Readers etc . Better to change the PDF version of online edition in to an E- Book form.

8. Size of Management accountant should be reduced to make it same as any International Management Accounting Magazine and repetitive information i.e. chapter information /address/ activities etc to be taken care in online edition and may be published on periodic basis only in paper edition. Photographs on back/front pages to be published periodically. Fonts to be changed to get sleekness so that publication becomes more attractive.

Have a nice cost effective day!

With Best regards,

Davinder Bhatia
Cost Management Specialist
484 Savoline Blvd,
Milton, Ontario, Canada
L9T7X3
647-237-8465, 905-593-2728

Our reply : Thanks for your valuable inputs. We will revert to you on the same.

Dear Sir,

The article in March 2012 issue on the case study section titled ''Hindustan Unilever's Cost Aggression'' by Ms Kaberi Bhattacharya is one of the best articles of the March 2012 issue. It is informative and analytically excellent.

It exhibits what parameters should be considered for preparing the base for good SDSS (Strategic Decision Support System) by the corporate houses.

Thanks for enriching our journal with such an excellent article

Regards

Prashant Dahivalkar ACMA
M/28526

■ **Letters may be edited for brevity**

THE INSTITUTE OF COST ACCOUNTANTS OF INDIA
(statutory body under an Act of Parliament)

MANAGEMENT DEVELOPMENT PROGRAMMES 2012-13

DURATION	TOPIC	VENUE	FEE (RS.) NON – RESIDENTIAL	FEE (RS.) RESIDENTIAL SINGLE ROOM BASIS
	APRIL, 2012			
19-20	Workshop on Presentation and Disclosures of Financial Statements – As per the Revised Schedule VI to the Companies Act, 1956	New Delhi	10000*	
	MAY, 2012			
17-18	Workshop on Presentation and Disclosures of Financial Statements-As per the Revised Schedule VI to the Companies Act, 1956	New Delhi	10000*	
23-26	Contracts and their Management	Gangtok, Sikkim	-	35000*
23-26	Recent Trends in Corporate Reporting including IFRS and Revised Schedule VI – by Dr. T.P. Ghosh	Gangtok, Sikkim		35000*
30-31	Updates on Direct and Indirect Taxation	Delhi	10000*	
	JUNE, 2012			
11-12	Updates on Direct and Indirect Taxation	Chennai	8000*	
12-15	IFRS Updates & Converged Indian Accounting Standards by Dr. T. P. Ghosh	Srinagar	-	35000*
12-15	Finance for Junior Finance and Accounts Officers and Non Executives(F & A)	Srinagar	-	35000*
19-22	Risk Based Internal Audit and Corporate Governance	Ooty, T.N	-	35000*
19-22	Emerging Issues in Direct & Indirect Taxation	Ooty, T.N		35000*
27-1st July	Certificate Course on IFRS and Converged Indian Accounting Standards	Bangalore	25000*	
	JULY, 2012			
11-13	Project - Appraisal, Financing and Management	Delhi	15000*	-
18-22	Certificate Course on IFRS and Converged Indian Accounting Standards	Kolkata	25000*	-
24-27	Issues in Corporate Taxation– Planning, Compliance and Management	Udaipur		35000*
24-27	Recent Trends in Corporate Reporting including IFRS and Revised Schedule VI	Udaipur	-	35000*
26-28	Workshop on Accounting for Financial Instruments	Delhi	15000*	-
	AUGUST, 2012			
06-09	Contracts and their Management	Portblair	-	38000*
06-09	Emerging Issues in Direct and Indirect Taxation	Portblair	-	38000*
22-26	Certificate Course on IFRS and Converged Indian Accounting Standards	Hyderabad	25000*	
28-31	Basic Financial Skills for Non Finance Executives and Engineers	Hyderabad		35000*
28-29	Performance reporting- A Way forward in Corporate Governance	Hyderabad	8000*	
	SEPTEMBER, 2012			
11-14	Risk Based Internal Audit and corporate Governance	Pondicherry	-	35000*
11-14	Issues in Direct Taxation- Advance Tax, TDS and Tax Planning	Pondicherry		35000*
26-30	Certificate Course on IFRS and Converged Indian Accounting Standards	New Delhi	25000*	

OCTOBER, 2012

09-12	Recent Trends in Corporate Reporting and corporate Finance including IFRS	Vayalar, (Backwater) Kerala	-	38000*
15-18	Emerging Issues in Management of Taxation	Goa	-	35000*
15-18	Activity Based Costing and Management	Goa	-	35000*

NOVEMBER, 2012

20-23	Basic Financial Skills for Non Finance Executives and Engineers	Mysore		35000*
29 Nov. – Dec.8	International Programme on `Strategic Financial Management'	Singapore, Kualalumpur & Bangkok	-	250000*

DECEMBER, 2012

11-14	Recent Trends in Financial Management	Amritsar		35000*
18-21	Contracts and their Management	Shirdi	-	35000*
18-21	Emerging Issues in Direct and Indirect Taxation	Shirdi	-	35000*
26-30	Certificate Course on IFRS and Converged Indian Accounting Standards	Mumbai	25000*	-

JANUARY, 2013

02-04	Costing for Engineers	Chennai	15000*	40000*
08-12	Recent Trends in Corporate Reporting including IFRS and Revised Schedule VI	Hyderabad	-	35000*
08-12	Advance Tax, TDS and Tax Planning	Hyderabad	-	35000*

FEBRUARY, 2013

19-22	Risk Based Internal Audit for Effective Management Control	Puri	-	35000*
19-22	Emerging Issues in Management of Taxation	Puri	-	35000*

Note :- *Plus 12.36% Service Tax.

For Non-Residential Programmes - Fee includes course fee, course material, lunch, tea/coffee etc.

For Residential Programmes - Fee includes course fee, course material, accommodation on Single Room basis, all meals and visits. The charges for accompanying spouse would be Rs. 1000/- (Rupees one thousand only) towards accommodation, all meals and visits for all the three days excluding International programmes.

CEP Credit Hours - (For 1 Day Prog. - 4 Hours) (For 2 Days Prpg. - 6 Hours) (For 3 Days & more Prog.-10 Hours)

For Kind Information:

For outstation programmes the participants are requested to get the confirmation from the Institute before proceeding to the venue. If any participant reaches the venue for the postponed/cancelled programmes without getting the confirmation from the Institute, the Institute will not be held responsible for the same. The cancellation/postponement of the programmes, if any, will be intimated to only those organizations whose nominations have been received by the Institute on time.

For residential programmes normally the first day check-in is at 12.00 noon and last day check-out is at 12.00noon

The Payment of the Fee is to be made by Cheque/DD in favour of 'The Institute of Cost Accountants of India' payable at New Delhi.

Details for ECS Payment: State Bank of India (60321), Andhra Association Building, 24-25 Institutional Area, Lodhi Road, New Delhi- 110003

Current A/c No. 30678404793 MICR Code : 110002493 IFCS Code : SBIN0060321

LIST OF EXCLUSIVE TAILOR-MADE IN-HOUSE PROGRAMMES OFFERED BY THE INSTITUTE

- Converged Indian Accounting Standards
- Activity Based Costing and Management
- Advance Tax, TDS and Tax Planning
- Capital Budgeting and Investment Decisions
- Corporate Tax - Planning, Compliance and Management
- Cost Accounting Records Rules and Cost Audit Report Rules (CARR & CAR)
- Contract Management
- Corporate Taxation
- Cost Analysis
- Cost Management
- Cost Control and Cost Effectiveness
- Costing for Engineers
- Derivatives and Risk Management
- Evolving from Manager to Leader
- Finance for Junior Finance and Accounts Officers and Non-Executives (F&A)
- Financial Management
- Financial Management for NGOs and Autonomous Bodies
- Finance for Non-Finance Executives
- Financial Risk Management
- Foreign Exchange Risk Management
- Import-Export Procedures and Documentation
- International Financial Reporting Standards (IFRS)
- Management Accounting
- Management of Taxation
- Managerial Effectiveness
- Materials Management
- Orientation Programme for Executives/Non-Executives
- Project Cost Management
- Project Management and Project Financing
- Revised Schedule VI
- Risk Based Internal Audit for Effective Management Control
- Service Tax
- VAT
- Valuation and DCF Modelling using Excel

LIST OF ORGANIZATIONS BENEFITED FROM ICAI EXCLUSIVE IN-HOUSE PROGRAMMES

- Airports Authority of India
- Bhakra Beas Management Board
- Bharat Aluminium company Ltd.
- Bharat Heavy Electricals Ltd.
- Bharat Sanchar Nigam Limited
- Central Electricity Regulatory Commission
- Council of Scientific & Industrial Research (CSIR)
- CAG office, New Delhi
- DCM Limited
- Delhi Jal Board
- Delhi Tourism & Transportation Development Corp. Ltd.
- Delhi Transco Ltd.
- Department of Personnel and Training, Govt. of India
- Department of Posts, Govt. of India
- Directorate General of Quality Assurance (DGQA), Ministry of Defence, Govt. of India
- Engineers India Ltd.
- GAIL (India) Ltd.
- Hindustan Copper Limited
- HUDCO Ltd.
- IBP Company Limited
- Indian Air Force
- Indian Navy
- Indian Farmers Fertiliser Cooperative Ltd.
- Indian Oil Corporation Limited
- Indian Railway Catering and Tourism Corp. Ltd. (IRCTC)
- Indian Railways
- Indian Renewable Energy Development Agency Ltd.
- IRCON International Ltd.
- KRIBHCO Ltd.
- Lanco Group of Companies
- Mahanadi Coalfields Ltd.
- Mahanagar Telephone Nigam Ltd.
- Maruti Udyog Ltd.
- MMTC Ltd.
- Ministry of Tourism, Govt of India
- National Academy of Customs, Excise and Narcotics
- National Academy of Defence Accounts
- National Aluminium Co. Ltd.
- National Highways Authority of India Ltd.
- National Seeds Corporation Ltd.
- Nepal Electricity Authority, Kathmandu, Nepal
- Nepal Telecom Co., Kathmandu, Nepal
- Nuclear Power Corporation of India Ltd. (RAPS)
- North Eastern Electric Power Co. Ltd.
- O.N.G.C. Ltd.
- Ordnance Factory Board
- Oil Industry Development Board
- Power Finance Corporation Ltd.
- Power Grid Corp. of India Ltd.
- Power Transmission Corp. of Uttrakhand Ltd.
- Railtel Corp. of India Ltd.
- RITES Limited
- Rural Electrification Corp. Ltd.
- SJVN Limited
- Tata Power Co. Ltd.
- THDC India Ltd.
- West Bengal State Electricity Distribution Co. Ltd.

ABOUT THE INSTITUTE

The Institute of Cost Accountants of India was established by the Government of India as an autonomous professional Institute in 1959 to provide training, Education and research facilities in Cost and Management Accounting. The Institute is a member of the International Federation of Accountants (IFAC), the Confederation of Asian & Pacific Accountants (CAPA) and the South Asian Federation of Accountants (SAFA).

THE OBJECTIVES

- To promote the knowledge of Cost and Management Accountancy, to provide educational facilities for training of young men and women for building careers in management accounting.
- To improve the decision making skills and administrative competence relevant to management accounting and corporate management in general.
- To create knowledge through research both applied and conceptual relevant to management accounting and its undenying disciplines so as to disseminate such knowledge through publications.

FOR FURTHER DETAILS AND REGISTRATION PLEASE CONTACT:

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Chairman,
Countinuing Education Programme Committee
CMA Hari Krishan Goel

Cost Accounting

By M Y Khan & P K Jain

Tata McGraw Hill Education Private Ltd.

Fifteenth Reprint 2011

Price : Not Indicated

Cost Accounting discipline requires its students to have a firm hold on the subject with clarity and understanding. One has to be conversant with the concepts, methods of cost ascertainment, application of the methods in decision-making process and, finally, for installation of a cost accounting system. The entire gamut of operations related to Cost Accounting has been comprehensively covered in the book under review.

Starting with an overview of the subject, the authors have, in a student-friendly manner, taken up all related aspects in a planned way.

The reader gets introduced to the basics, the essential difference between cost accounting and other accounting disciplines—like financial accounting and management accounting—and then, progressively, to the various costs that are available for this accounting discipline.

One interesting feature is that most of the nineteen chapters—that are grouped under three parts—provide a gist of the portion covered, related references, practical examples with working notes and exercises with solutions—to tone up one's understanding of the subject.

Material, Labour and Overheads form the three principal components of cost accounting. Their treatment and usage vary—depending on the requirements and their classification as direct or indirect, fixed, variable or semi-variable. There are various processes of cost accounting that come into play, it could be job costing, process costing, unit costing, and so on. The nuances of each process or system of costing have to be understood for better profit planning and performance measurement. It is here that the book scores.

Mention must be made of the chapters that discuss installation of a costing system, reconciliation and integration and variance analysis for their lucid presentation. The comfort level of the reader is bound to increase.

The book also deals with the advantages and limitations of variable costing, its role in profit planning and cost control measures.

Variable costing is required for internal control. Its usefulness to the management is in carrying out profit planning exercises in specific situations and cost control in general. Undeniably, variable costing has a vital role to play in situations where fixed costs do not come into the picture and short term perspectives have to be taken into account for decision-making. They have taken up cost accounting techniques as a tool for profit planning, cost-volume-profit relationship and budgeting.

As envisaged by the authors, this book will certainly be useful not only to the students and teachers but also to all professionals dealing with Cost Accounting.

M. S. Vaidyanathan
ACMA, ACS
Senior Manager, Indian Bank

A Guide to Cost Accounting Standards

By Shri Ajay Deep Wadhwa

Modern Law Publications

First Edition, 2011

Price : 275.00

Since the first edition of this book there has been considerable and complex study of cost accounting standards. Where first part of the book deals with the importance of cost accounting standards, the 2nd part of the book deals mainly with various cost accounting standards. Recent changes and amendments have been incorporated wherever necessary.

The unique and distinct features of the present edition are outlined hereunder :

1. The full text of the cost accounting standards, with objective, scope, clarifications etc. have been included.
2. Practical aspects of each and every cost accounting standards has been incorporated at the end of each chapter.
3. Scope and applicability of cost accounting standards have been incorporated at appropriate place.
4. Relevant sections of Companies Act, 1956 related to accounts has also been included in the appendix to have a overall concept of the cost accounting standards with the Companies Act.

This book is an unique book so far as cost accounting standards are concerned. Clear and vivid picture of the Cost Audit Report Rules 2011 & Cost Accounting Record Rules 2011 have been depicted here. This book provide guidelines to cost accountants in preparation of uniform cost statements, to make standard approach towards maintenance of cost accounting record rules & understanding cost audit & certain provisions of company law including other acts like Income Tax Act, Central Excise, Customs, Sales Tax Act etc.

This book gives the management to follow the standard cost accounting practices & preparation of uniform cost statement in the matter of compliance of statutory obligations.

This book gives a total picture regarding appointment of cost auditors by companies. This book will definitely cater to the needs of the students as well as the professionals and will be a constant guide to the readers and professionals.

Chandrani Dutta
B.Sc. (Hons), ACS

Some of the Companies whose search for CMAs ended in the Campus Placement conducted by the Institute in April 2012

A Cross Section of distinguished audience at Regional Cost Conference. Seen are Shri A. Das, past President, Shri T.C.A. Srinivasa Prasad, Council Member of the Institute & other guests.

Regional Cost Conference 2012 in progress at Durgapur.

Vice President of the Institute addressing the delegates at Regional Cost Conference 2012 at Durgapur.

President of the Institute felicitating Smt. Nandna Munshi, Govt. nominee at the Quality Review Board meeting held at Kolkata. Also seen Dr. Navrang Saini, Regional Director (E & NER), MCA, GoI.

President of the Institute felicitating, Shri V. Kalyanaraman, Past President of the Institute at the Quality Review Board meeting held at Kolkata.

Dr. P.V.S. Jagan Mmohan Rao interacting with the RCMs.

Group photograph taken on the inauguration of two day Workshop on "Presentation and Disclosures of Financial Statements - As per the Revised Schedule VI to the Companies Act, 1956" held at New Delhi.

Shri M. Acharjee, AGM (Taxation & Audit) Balmer Lawrie Co. Ltd inaugurating the sacred lamp at the Budget Discussion held at the Institute HQ. Also seen Council Members Dr. Sanjiban Bandyopadhyaya & Shri Manas Thakur along with other dignitaries.

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Glimpses of Campus Placements held at four Regions in April 2012

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