



**ICMAI**  
**THE INSTITUTE OF  
COST ACCOUNTANTS OF INDIA**  
भारतीय लागत लेखाकार संस्थान  
Statutory Body under an Act of Parliament  
(Under the jurisdiction of Ministry of Corporate Affairs)  
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# CMA STUDENT E-Bulletin

VOL 11 | NO. 05 | MAY 2026

*An Initiative of Directorate of Studies*

Behind every successful business decision, there is always a **CMA**

## About the Institute

The Institute of Cost Accountants of India (ICMAI) is a statutory body set up under an Act of Parliament in the year 1959. The Institute as a part of its obligation, regulates the profession of Cost and Management Accountancy, enrolls students for its courses, provides coaching facilities to the students, organizes professional development programmes for the members and undertakes research programmes in the field of Cost and Management Accountancy. The Institute pursues the vision of cost competitiveness, cost management, efficient use of resources and structured approach to cost accounting as the key drivers of the profession. In today's world, the profession of conventional accounting and auditing has taken a back seat and cost and management accountants increasingly contributing towards the management of scarce resources like funds, land and apply strategic decisions. This has opened up further scope and tremendous opportunities for cost accountants in India and abroad.

The Institute is headquartered in New Delhi having four Regional Councils at Kolkata, Delhi, Mumbai and Chennai, 113 Chapters in India and 11 Overseas Centres. The Institute is the largest Cost & Management Accounting body in the world with about 1,00,000<sup>+</sup> qualified professionals and over 6,00,000<sup>+</sup> students pursuing the CMA Course. The Institute is a founder member of International Federation of Accountants (IFAC), Confederation of Asian and Pacific Accountants (CAPA) and South Asian Federation of Accountants (SAFA). The Institute is also an Associate Member of ASEAN Federation of Accountants (AFA) and member in the Council of International Integrated Reporting Council (IIRC), UK.

### 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.”

### Mission Statement

“The CMA 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.”

### Institute Motto

असतोमा सदगमय  
तमसोमा ज्योतिर् गमय  
मृत्योर्मा मृतं गमय  
ॐ शान्ति शान्ति शान्तिः

From ignorance, lead me to truth  
From darkness, lead me to light  
From death, lead me to immortality  
Peace, Peace, Peace

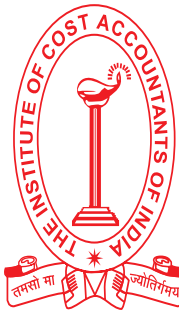
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# CHAIRMAN'S COMMUNIQUE

**Dear CMA Students,**

**I**t gives me immense pleasure to connect with you through the May 2026 issue of the CMA Student E-Bulletin. As the Chairman of the Training & Educational Facilities Committee of ICAI, I am excited to share the latest developments and initiatives that aim to enhance your learning experience and professional growth.

At ICAI, our commitment to excellence in education and training remains unwavering. We continuously strive to provide you with the best resources, state-of-the-art facilities, and cutting-edge training programs that will prepare you to excel in the field of cost and management accounting. Your success is our primary motivation, and we are dedicated to supporting you every step of the way.

In today's digital age, leveraging technology to facilitate learning is paramount. We have introduced several innovative learning platforms to ensure that you have access to high-quality education regardless of your location. Our online classes, interactive webinars, and virtual workshops provide you with the flexibility to learn at your own pace while maintaining the highest standards of education.

In addition to theoretical knowledge, practical skills are crucial for your professional development. We have designed a variety of skill development programs that focus on real-world applications and industry-relevant practices. These programs include case studies, simulation exercises, and hands-on training sessions that bridge the gap between academic knowledge and practical implementation. Our collaborations with leading organizations and industry experts provide you with invaluable insights and opportunities to apply your knowledge

in real-world scenarios. Through internships, live projects, and guest lectures, you can gain practical experience and understand the nuances of the industry. These collaborations also open doors to networking opportunities that can be instrumental in your career growth.

At ICAI, we believe in the holistic development of our students. Alongside academic excellence, we emphasize the importance of soft skills such as communication, leadership, and teamwork. Our comprehensive training programs include workshops and seminars focused on developing these essential skills, ensuring that you are well-rounded professionals ready to take on leadership roles.

I am confident that the initiatives and programs we have implemented will significantly enhance your learning experience and prepare you for a successful career. I encourage you to take full advantage of these opportunities and remain dedicated to your goals.

I extend my best wishes to all of you. Your hard work, determination, and passion are the driving forces behind our efforts. Let us continue to work together to achieve excellence and elevate the standards of the cost and management accounting profession.

Warm regards,

**CMA Vinayranjan P.**

**Chairman, Training & Educational Facilities  
Committee, ICAI**

# CMA FOUNDATION COURSE

Syllabus 2022

## Topic

Fundamentals of  
Business Laws -

Module 3:  
Sale of Goods Act,  
1930

Business  
Communication -

Module 5:  
Business  
Communication

## FOUNDATION

### Paper-1

Fundamentals of  
Business Laws and  
Business  
Communication  
(FBLC)

## SECTION – A: FUNDAMENTALS OF BUSINESS LAWS

1. Under the Sale of Goods Act, 1930, which of the following elements is NOT essential to constitute a valid 'contract of sale'?
  - (a) Two parties capable of contracting
  - (b) Transfer or agreement to transfer ownership of goods
  - (c) Immediate delivery of goods
  - (d) A price in money paid or promised
2. A contract for the supply and installation of machinery at a buyer's factory involves both goods and labour. Under the Sale of Goods Act, 1930, such a contract is:
  - (a) Always treated as a pure contract of sale of goods
  - (b) A contract for work and labour and not a sale of goods
  - (c) Either a contract of sale or a works contract depending on the dominant purpose of the transaction
  - (d) A hire-purchase agreement
3. Under Section 6 of the Sale of Goods Act, 1930, when there is a contract for the sale of specific goods and the goods have, without the knowledge of the seller, perished at the time of making the contract, the contract is:
  - (a) Voidable at the option of the buyer
  - (b) Voidable at the option of the seller
  - (c) Void
  - (d) Valid with reduced price
4. Ankita agrees to sell her registered motorcycle to Bharat for Rs.75,000. Bharat pays the full price on Monday, but Ankita retains the motorcycle for servicing and agrees to deliver it on Wednesday. The motorcycle is damaged in a fire at the garage on Tuesday night without any fault of either party. Who bears the loss?
  - (a) Ankita, because she still had possession of the motorcycle
  - (b) Bharat, because ownership had already passed to him when the contract was made and price was paid
  - (c) Both equally, because delivery had not yet occurred
  - (d) The garage owner, because the goods were in his custody
5. Which of the following correctly distinguishes 'ascertained goods' from 'unascertained goods' under the Sale of Goods Act, 1930?
  - (a) Ascertained goods are future goods; unascertained goods are existing goods
  - (b) Ascertained goods are identified and agreed upon after the contract is formed; unascertained goods are identified before the contract
  - (c) Ascertained goods are identified and set apart after the contract is formed; unascertained goods are not yet identified or separated
  - (d) There is no legal distinction between the two categories
6. Vijay agrees to sell 200 litres of milk from his dairy farm to a hotel. Before the milk is separated or measured, the entire stock is destroyed due to a fire. Which legal principle applies to determine who bears the loss?
  - (a) Risk passes with delivery, so the hotel bears the loss
  - (b) Risk passes with ownership; since the goods were unascertained, ownership had not passed, so Vijay bears the loss
  - (c) Both parties share the loss equally because neither was at fault
  - (d) The insurance company automatically bears such losses
7. Under Section 17 of the Sale of Goods Act, 1930, in a sale by sample, which of the following conditions is implied?
  - (a) The goods shall correspond in quality to the sample shown
  - (b) The buyer shall be given an opportunity to inspect and compare the bulk with the sample
  - (c) The goods shall be free from any defect making them unmerchantable that would not be apparent on reasonable examination of the sample
  - (d) All of the above
8. Prashant buys a used car from a car dealer. The dealer does not specifically warrant the condition of the car, but sells it in the ordinary course of business. The car breaks down within a week due to a latent engine defect that a reasonable inspection could not have detected. Prashant's remedy lies under:
  - (a) Implied condition as to title under Section 14(a)
  - (b) Implied condition of merchantable quality under Section 16(2)
  - (c) Express warranty given by the dealer
  - (d) Prashant has no remedy since it is a used car

9. Under the Sale of Goods Act, 1930, the maxim 'caveat emptor' (let the buyer beware) does NOT apply when:
- The buyer inspects the goods before purchase and finds no visible defect
  - The buyer relies on the seller's skill or judgment and makes known the particular purpose for which goods are required
  - The buyer and seller are both experts in the same trade
  - The goods are purchased from a private individual and not a dealer
10. Goods are sent to a buyer 'on approval' on 1st March. The buyer neither accepts nor rejects the goods, nor does he return them. The period fixed for return is 15 days. On 20th March, a thief breaks into the buyer's premises and steals the goods. Who bears the loss?
- The seller, since no formal acceptance was communicated
  - The buyer, because the approval period had lapsed and ownership had passed to him
  - Both equally, as the theft was an act of third party
  - The insurance company, if the goods were insured
11. A seller delivers 800 metres of cloth against a contract for 1,000 metres. Under Section 37 of the Sale of Goods Act, 1930, the buyer's right in this situation is:
- To reject the 800 metres and wait for delivery of the balance
  - To accept the 800 metres delivered and pay at the contract rate, while treating the shortfall as breach
  - To reject all goods since the contract required 1,000 metres
  - Either to accept only 800 metres at contract rate or reject the whole consignment
12. Under the Sale of Goods Act, 1930, which of the following conditions must be satisfied for the right of stoppage in transit to be exercised by an unpaid seller?
- The buyer must be solvent and goods must be in transit
  - The buyer must be insolvent and goods must be in transit in the hands of a carrier or other bailee
  - The buyer must have rejected the goods before transit begins
  - The seller must have regained physical possession of the goods
13. Rakesh, an unpaid seller, exercises his right of lien over goods still in his possession. The buyer then sells those goods to an innocent third party by transfer of the document of title. What happens to Rakesh's lien?
- The lien continues as it is a statutory right and cannot be defeated
  - The lien is defeated only if the innocent third party pays a higher price
  - The lien is defeated if the transfer is by way of sale to a person who takes in good faith for value
  - The lien is automatically discharged when the buyer enters into a secondary contract
14. Under Section 55 of the Sale of Goods Act, 1930, when the seller sues for the price of goods, this remedy is available:
- Only when ownership has passed to the buyer and the buyer refuses to pay
  - Whenever the buyer refuses to accept the goods, regardless of whether ownership has passed
  - Only when the goods have been physically delivered to the buyer
  - Only when the buyer has examined and accepted the goods
15. A sells 100 bags of rice to B on credit for 60 days and delivers the goods. After 30 days, B becomes insolvent. Which of the following rights can the unpaid seller A exercise at this stage?
- Right of lien, since the credit period has not yet expired
  - Right of stoppage in transit, if the goods are still in transit
  - Right to rescind the contract and demand the goods back from B
  - No right, since A voluntarily gave credit and goods were already delivered
16. At an auction sale, the auctioneer accidentally knocks down a lot to a bidder even though the reserve price had not been reached. The effect of such a sale is that the contract is:
- Valid and binding, since the auctioneer's knock-down is conclusive
  - Voidable at the option of the highest bidder
  - Not concluded, since a knock-down below the reserve price does not create a valid contract
  - Valid, but the buyer must pay the reserve price instead of the bid price

17. Sunita goes to a textile shop and asks for fabric 'suitable for making uniforms that will withstand industrial washing at 90 degrees Celsius'. The shopkeeper sells her a synthetic fabric that disintegrates at that temperature. The implied condition breached is:
- Condition as to title under Section 14
  - Condition as to correspondence with description under Section 15
  - Condition of fitness for a particular purpose under Section 16(1)
  - Condition of merchantable quality under Section 16(2)
18. Which of the following is an exception to the general rule of 'Nemo dat quod non habet' under the Sale of Goods Act, 1930?
- Sale by a thief who is in possession of stolen goods
  - Sale by a mercantile agent acting within the ordinary scope of his authority when buyer acts in good faith
  - Sale of goods by a bailee without the bailor's permission
  - Sale by a pledgee after the pledgor has repaid the loan
19. Under the Sale of Goods Act, 1930, a 'warranty' is distinguished from a 'condition' primarily in that:
- A warranty is an oral stipulation; a condition must be written
  - Breach of a warranty entitles the buyer to repudiate the contract, whereas breach of a condition only gives a right to damages
  - Breach of a condition entitles the buyer to treat the contract as repudiated, whereas breach of a warranty only gives rise to a claim for damages
  - Warranties apply only to specific goods; conditions apply only to future goods
20. A buyer accepts a part of the goods delivered to him. Subsequently, he discovers that the remaining goods do not conform to the contract. Under the Sale of Goods Act, 1930, the buyer's right with respect to the non-conforming portion is:
- He must accept all goods since he accepted part of the delivery
  - He can reject only the non-conforming goods and accept the conforming ones
  - He must reject all goods including those already accepted
  - He loses all remedies once any part of the delivery is accepted
21. Under Section 64 of the Sale of Goods Act, 1930, which of the following statements about auction sales is CORRECT?
- A seller may employ a puffer or dummy bidder without disclosing this to raise prices without any legal consequences
  - A bid once made at an auction cannot be retracted before the fall of the hammer
  - Each lot put up at an auction is prima facie deemed a separate contract of sale
  - The highest bidder must mandatorily be declared the buyer at the fall of the hammer irrespective of reserve price
22. An unpaid seller exercises his right of lien over goods still in his possession. The buyer then sells those goods to an innocent third party by transferring the document of title to that person. Under Section 47(2) of the Sale of Goods Act, 1930, what happens to the unpaid seller's lien?
- The lien is defeated if the transfer is by way of sale to a person who takes in good faith for value
  - The lien continues as it is a statutory right and cannot be defeated
  - The lien is defeated only if the innocent third party pays a higher price than the original contract price
  - The lien is automatically discharged the moment the buyer enters into any secondary contract
23. Rohan, an unpaid seller, decides to exercise his right of resale after giving due notice to the defaulting buyer. He resells the goods at a price higher than the original contract price. The surplus amount obtained on resale belongs to:
- The original (defaulting) buyer, since the surplus arises from his own goods
  - The unpaid seller Rohan, as the resale is a statutory right exercised at his initiative
  - Be divided equally between Rohan and the original buyer
  - Be deposited with the court until further orders
24. Under the Sale of Goods Act, 1930, the goods are said to be in a 'deliverable state' when:
- The goods have been physically delivered to the buyer or the carrier
  - They are in such condition that the buyer would, under the contract, be bound to take delivery
  - The seller has given notice to the buyer to collect the goods
  - The risk in the goods has passed from the seller to the buyer

25. Which of the following best describes the term 'channel' in the communication process?
- The idea that the sender wishes to convey
  - The medium through which the message travels from sender to receiver
  - The response given by the receiver to the sender
  - The noise that distorts the message during transmission
26. A business letter that aims to recover an overdue payment from a customer while maintaining the business relationship exemplifies which quality of effective communication?
- Conciseness
  - Correctness
  - Consideration
  - Completeness
27. Which of the following is the most accurate description of 'lateral communication' in an organisation?
- Communication from the Board of Directors to all employees simultaneously
  - Communication between employees belonging to the same hierarchical level across different departments
  - Communication from a junior employee to a senior official reporting a problem
  - Communication from head office to all branch offices
28. A manager consistently ignores emails from a subordinate who proposed a new cost-saving idea. This is an example of which barrier to communication?
- Semantic barrier
  - Physical barrier
  - Attitudinal or psychological barrier
  - Channel barrier
29. In business correspondence, the 'subject line' of a formal letter primarily serves to:
- State the date and place of writing
  - Introduce the sender's designation
  - Indicate the main topic of the letter at a glance
  - Acknowledge receipt of the previous communication
30. Which of the following statements about oral communication is NOT correct?
- It allows immediate feedback from the receiver
  - It is suitable for conveying complex technical instructions that require future reference
  - It includes voice modulation and tone as elements of the message
  - It is generally faster than written communication for simple messages

**Answer:**

1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
c	c	c	b	c	b	d	b	b	b	d	b	c	a	b
16	17	18	19	20	21	22	23	24	25	26	27	28	29	30
c	c	b	c	b	c	a	a	b	b	c	b	c	c	b

## Topic

Fundamentals  
of Financial  
Accounting -

Module 1:  
Accounting  
Fundamentals

Fundamentals of  
Cost Accounting -

Module 4:  
Fundamentals of  
Cost Accounting

## FOUNDATION

### Paper-2

Fundamentals of  
Financial and Cost  
Accounting (FFCA)

## FUNDAMENTALS OF FINANCIAL ACCOUNTING

1. Business is said to be in a profit when
  - A) Expenditure exceeds income
  - B) Income exceeds expenditure
  - C) Income exceeds liability
  - D) Assets exceed expenditure
2. As per the accounting double-entry system, when expense increases, it is \_\_\_\_\_.
  - A) No need to show as an accounting record.
  - B) Credited.
  - C) Debited.
  - D) Both (B) and (C).
3. What does the term “credit” mean in business?
  - A) agreement between a lender and a borrower
  - B) revenue a business earns from selling its goods
  - C) cost of operations that a company incurs to generate revenue
  - D) own with the expectation to provide a future benefit
4. When a Liability is decreased or reduced, it is registered on the
  - A) Debit side or left side of the account
  - B) Credit side or right side of the account
  - C) Debit side or right side of the account
  - D) Credit side or left side of the account
5. When there is an increase in capital by an amount, it is registered on the
  - A) Credit or right side of the account
  - B) Debit or left side of the account
  - C) Credit or left side of the account
  - D) Debit or right side of the account
6. What kind of expenses are paid from Gross Profit?
  - A) Selling Expenses
  - B) Financial Expenses
  - C) General Expenses
  - D) All of the above
7. Which option gives a review report on the firm’s financial status at a specified date?
  - A) Income & Expenditure Account
  - B) Balance Sheet
  - C) Cash Flow Statement
  - D) Profit & Loss Account
8. Which of the options is not an intangible asset?
  - A) Land
  - B) Patents
  - C) Goodwill
  - D) Franchise rights
9. Which of the options is an example of business liability?
  - A) Creditors
  - B) Cash
  - C) Building
  - D) Land
10. The unfavourable balance of Profit and Loss account should be
  - A) Subtracted from liabilities
  - B) Subtracted from capital
  - C) Subtracted from current assets
  - D) Added in liabilities
11. Income tax paid by a sole trader on his business income should be:
  - A) Credited to his capital Account
  - B) Credited to Trading Account
  - C) Debited to Profit and Loss Account
  - D) Debited to Capital Account
12. An example of fictitious asset is:
  - A) Patent right
  - B) Preliminary Expenses
  - C) Furniture
  - D) Investment

13. Trade mark is a/an:
- Fictitious asset
  - Intangible asset
  - Current asset
  - Liquid asset
14. Outstanding rent is a:
- Representative Personal Account
  - Real Account
  - Nominal Account
  - Personal Account Balance Sheet reveals:
15. It is necessary to make a distinction between capital and revenue items because:
- It is helpful to assess financial position
  - It is helpful in calculating true profit or loss
  - It is required by accounting principles
  - All of the above
16. Which of the following is not a revenue receipt?
- Discount received
  - Sales made
  - Sale of Plant
  - Commission
17. Which liability is not shown in Balance Sheet?
- Contingent Liability
  - Current Liability
  - Long-term Liability
  - None of the above
18. Which of the following is not deducted from capital?
- Loss
  - Drawings
  - Loan
  - Income Tax
19. Closing stock is shown:
- Only in the Trial Balance
  - Only in the Profit & Loss Accounts
  - In the Trading Account and Balance Sheet
  - Only in the Balance Sheet
20. Outstanding expenses are:
- Current assets
  - Non-current liabilities
  - Current liabilities
  - Prepaid expenses
21. Gross Profit is transferred to :
- Trading Account
  - Profit and Loss Account
  - Balance Sheet
  - Cash Book
22. Prime Cost is ₹50,000. Direct Labour is 70% of Prime Cost. What is the amount of Direct Material?
- ₹35,000
  - ₹15,000
  - ₹50,000
  - ₹20,000
23. Raw Material Consumed = ₹26,500, Opening Stock = ₹3,000, Closing Stock = ₹4,500. Purchases =
- ₹23,000
  - ₹28,000
  - ₹30,000
  - ₹27,00
24. A cost unit is:
- A unit of measurement for cost ascertainment
  - A cost element
  - A ledger account
  - An overhead
25. Statement showing break-up of costs is known as:
- Cost-sheet
  - Statement of profit
  - Production account
  - Tender
26. According to Cost Accounting Standard 1 (CAS-1), cost classification is primarily based on which of the following factors?
- Nature, function, and behaviour

- B) Purpose, production, and profit  
 C) Income, expenses, and assets  
 D) Cash flow and accrual
27. Which of the following is not a component of total cost?  
 A) Prime cost  
 B) Factory cost  
 C) Financial cost  
 D) Selling and distribution overhead
28. Gross Factory Cost = 58,000. Net Factory Cost = 54,000. Opening stock of work-in-progress is 8,000. Find closing stock of work-in-progress.  
 A) ₹10,000  
 B) ₹12,000  
 C) ₹14,000  
 D) ₹16,000
29. What are direct expenses also known as?  
 A) Overhead expenses  
 B) Sundry expenses  
 C) Chargeable expense  
 D) Major expenses
30. Warehouse rent is a part of which cost?  
 A) Production cost  
 B) Distribution cost  
 C) Prime cost  
 D) Factory cost

**Answer:**

1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
B	C	A	A	A	D	B	A	A	B	C	B	B	A	D
16	17	18	19	20	21	22	23	24	25	26	27	28	29	30
B	A	C	C	C	B	B	B	A	A	A	C	B	C	B

## Topic

Fundamentals  
of Business  
Mathematics -

Module 2:  
Algebra

Fundamentals of  
Business Statistics -

Module 8:  
Index Numbers and  
Time Series

## FOUNDATION

### Paper-3

Fundamentals  
of Business  
Mathematics and  
Statistics (FBMS)

## FUNDAMENTALS OF BUSINESS MATHEMATICS AND STATISTICS

In this issue we will carry out MCQs on Algebra and Time Series & Index Number--Refer Module 2 and Module 8 of Study guide

1. Simplified value of  $2^{7/8} * 2^{1/8} * 2^{6/8} * 2^{-2} * 2^{-6/8}$  is
  - a) -2
  - b)  $1/2$
  - c)  $-1/2$
  - d) None of the Above
2. The value of  $(9^3 * 9^4)/(9^{-4} * 9^9)$  is
  - a)  $9^4$
  - b)  $9^3$
  - c) 81
  - d) None of the above
3. If  ${}^n P_{11} : {}^n P_{12} = 3:1$ , the value of n.
  - a) 11
  - b) 12
  - c) 13
  - d) 15
4. The value of  $\frac{1}{19!} + \frac{1}{21!} + \frac{1}{20!}$ 
  - a)  $442 / 21!$
  - b)  $441 / 21!$
  - c)  $419 / 21!$
  - d)  $439 / 21!$
5. How many ways can 6 people get RT-PCR tested from 6 laboratories, assuming no laboratory is closed?
  - a) 120 ways.
  - b) 4320 ways.
  - c) 5040 ways.
  - d) 720 ways.
6. When 15 autos are running between Kolkata and Howrah. In how many ways can a passenger travel from Kolkata to Howrah and return by a different auto?
  - a) 210 ways.
  - b) 225 ways.
  - c) 15 ways.
  - d) 195 ways.
7. If sum of roots = 8, value of k for  $x^2 - (13/6) - (2k+3)x = 0$ .
  - a)  $k = 3.50$
  - b)  $k = 9/2$
  - c)  $k = 1.50$
  - d)  $k = 5/2$
8. Find the value of x in  $x^2 + 54 = 15x$ 
  - a)  $x = -6$  or  $-9$
  - b)  $x = -6$  or  $9$
  - c)  $x = 6$  or  $9$
  - d)  $x = 6$  or  $-9$
9. The value of:  $8^2 * 8^1$  is
  - a)  $2^9$
  - b)  $8^3$
  - c) Both 'a' and 'b'
  - d) None of the above
10. The value of  $2323 / 230$ 
  - a)  $23^0$
  - b)  $23^1$
  - c) 1
  - d)  $23^{23}$
11. From among 28 members in a bank, one manager, one cashier and one teller needs to be appointed. In how many ways could this be done?
  - a) 19556
  - b) 19665
  - c) 19656
  - d) 19565
12. Find the sum and product of roots of
  - a) -3,-5
  - b) -3, 5
  - c) 33, 55
  - d) -33, 55
13. A supermarket compares the prices of a basket of goods between 2020 and 2025. Which statistical tool is most suitable for measuring the overall change in prices?
  - a) Mean Deviation
  - b) Price Index Number
  - c) Correlation Coefficient
  - d) Probability Distribution

14. The primary purpose of a Consumer Price Index (CPI) is to:
- Measure company profits
  - Measure changes in the cost of living
  - Measure stock market performance
  - Measure employee productivity
15. A company's sales revenue increased by 15%. Management wants to know whether the increase came from higher quantities sold rather than higher prices. Which index should be used?
- Wage Index
  - Production Index
  - Sales Volume Index
  - Cost Index
16. A Sales Volume Index mainly measures changes in:
- Product prices
  - Interest rates
  - Employee salaries
  - Quantity of goods sold
17. A manufacturing company uses a Wage Index primarily to:
- Monitor changes in employee compensation over time
  - Measure machine efficiency
  - Evaluate product quality
  - Calculate depreciation
18. Which business function benefits most directly from analyzing a Wage Index?
- Marketing Management
  - Inventory Management
  - Human Resource Management
  - Logistics Management
19. A steel company compares its total production output across different years using a Production Index. The main purpose is to:
- Measure inflation
  - Measure operational performance
  - Measure customer satisfaction
  - Measure market share
20. A rising Production Index generally indicates:
- Reduced production activity
  - Stable prices
  - Increased production output
  - Lower employee wages
21. The Sensex and Nifty are examples of:
- Cost Indices
  - Wage Indices
  - Production Indices
  - Stock Market Indices
22. A significant rise in a stock market index often reflects:
- Improved investor confidence
  - Higher unemployment
  - Lower business activity
  - Reduced market liquidity
23. A manufacturing company tracks changes in the prices of copper, steel, and aluminum purchased each year. Which index is most relevant?
- Wage Index
  - Production Index
  - Purchasing Cost Index
  - Stock Market Index
24. Why is a Purchasing Cost Index important for a business?
- It helps determine employee promotions.
  - It measures customer satisfaction.
  - It assists in budgeting, cost control, and profit planning.
  - It measures stock market returns.
25. What is the primary objective of Time Series Analysis in business?
- To compare two unrelated variables
  - To study data collected over time and identify patterns
  - To calculate probability distributions
  - To determine market share only
26. A company's monthly sales data over the last 10 years are analyzed to identify long-term growth. Which component of a time series is being examined?
- Seasonal Variation
  - Cyclical Variation
  - Trend
  - Irregular Variation

27. A retail store experiences higher sales every year during the festive season. This pattern is an example of:
- Trend
  - Cyclical Variation
  - Seasonal Variation
  - Random Variation
28. During an economic recession, a company's profits decline for several years and then recover during economic expansion. This fluctuation is known as:
- Cyclical Variation
  - Seasonal Variation
  - Trend
  - Secular Movement
29. A sudden labor strike causes a sharp drop in production for one month. In Time Series Analysis, this is classified as:
- Trend Component
  - Seasonal Component
  - Cyclical Component
  - Irregular (Random) Component
30. Which of the following is not considered a major component of a time series?
- Trend
  - Seasonal Variation
  - Cyclical Variation
  - Correlation Coefficient

**Answer:**

1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
b	c	d	a	d	a	d	c	c	d	c	b	b	b	c
16	17	18	19	20	21	22	23	24	25	26	27	28	29	30
d	a	c	b	c	d	a	c	c	b	c	c	a	d	d

**Suggestions:**

*The study guide needs to be read thoroughly. Supplementary readings could be made from other resources. In this issue MCQs are based on basic concepts taught in the respective modules/sub modules of the study guide. Students should try to solve individual questions with expertise developed after studying guide book to understand the correct answer of each question. Formula used here are all covered in study guide.*

*Best Wishes.*

## Topic

Fundamentals of  
Business Economics -

Module 1 :  
Basic Concepts

Module 2 :  
Forms of Market

Fundamentals of  
Management -

Module 5:  
Fundamentals of  
Management

## FOUNDATION

### Paper-4

Fundamentals of  
Business Economics  
and Management  
(FBEM)

## FUNDAMENTALS OF BUSINESS ECONOMICS AND MANAGEMENT

Let us start our usual mock test.

### I. Choose the correct answer:

1. Who proposed the growth definition of economics?
  - A. Keynes
  - B. Marshall
  - C. Samuelson
  - D. Pigou
2. What is the normal shape of the PPF curve?
  - A. Concave to the origin
  - B. Convex to the origin
  - C. Straight line rising upward to the right
  - D. None of the above
3. If the seller sells at a fixed market price, then the MR curve will be
  - A. Vertical
  - B. Horizontal
  - C. Upward rising
  - D. Downward falling
4. If the seller has to reduce the price to increase sales, then with an increase in sales
  - A. Both AR & MR will rise
  - B. AR falls & MR rises
  - C. Both AR & MR will fall
  - D. MR falls & AR rises
5. Ceteris paribus means other things remaining
  - A. Negatively changed
  - B. Positively changed
  - C. Constant
  - D. None of the above
6. If the quantity demanded for good X is given by:  $Q_x = K/P_x$ , where,  $K > 0$ ,  $P_x =$  Price of good X, Then the MR curve is
  - A. Downward sloping
  - B. Indeterminate
  - C. Flat (horizontal) and lies above the horizontal axis
  - D. Coincides with the horizontal axis
7. For a normal demand curve the MR curve will
  - A. Appear below the demand curve
  - B. Appear above the demand curve
  - C. Parallel to the demand curve
  - D. None of the above
8. When both AR and MR are downward sloping straight lines, then the absolute slope of the AR curve will be
  - A. Twice that of the MR curve
  - B. Half of that of the MR curve
  - C. Equal to that of the MR curve
  - D. None of the above
9. The third phase of returns to a variable factor shows
  - A. Diminishing returns
  - B. Increasing returns
  - C. Negative returns
  - D. None of the above
10. When TP curve becomes an upward sloping straight line passing through the origin, then the  $MP = AP$  curve becomes
  - A. Horizontal
  - B. Vertical
  - C. Upward sloping
  - D. Downward sloping
11. In the long run, the possibility of greater technical division of labour in any factory leads to
  - A. Decreasing returns to scale
  - B. Constant returns to scale
  - C. Increasing returns to scale
  - D. None of the above
12. The MR curve of a competitive firm becomes
  - A. Vertical
  - B. Horizontal
  - C. Upward rising
  - D. None of the above
13. The long run equilibrium of a firm under perfect competition indicates that the plant size will be
  - A. Below optimum size
  - B. Over optimum size

- C. Optimum size  
D. None of the above
14. If  $SAC = AR$  of a competitive firm at its short-run equilibrium point, then it is called
- A. Shut down point  
B. Break-even point  
C. Turning point  
D. None of the above
15. A monopoly firm sells equilibrium quantity corresponding to which the price elasticity of demand is
- A. Relatively inelastic  
B. Relatively elastic  
C. Unit elastic  
D. Perfectly inelastic
16. At the profit maximizing output level of a monopolist, the marginal cost curve has to be upward rising
- A. True  
B. False  
C. Not necessarily true  
D. Usually false
17. A monopolist does not have a supply curve for its product because
- A. It is a price taker in the product market  
B. It can select both its output and its price  
C. The price is always fixed by the Govt.  
D. None of the above
18. Inflation means
- A. High price situation  
B. Stable price situation  
C. Rising price situation  
D. None of these
19. Monetary policy means
- A. Change in money supply of the economy  
B. Change in the tax rate of the economy  
C. Change in the Govt. expenditure of the economy  
D. All of these
20. Product differentiation is the other name of which one of the following market form?
- A. Perfect competition  
B. monopoly  
C. monopolistic competition  
D. none of the above
21. OPEC countries form a cartel under
- A. monopoly  
B. oligopoly  
C. monopolistic competition  
D. None of the above
22. Leadership is a part of
- A. Organization  
B. Management  
C. Both A & B  
D. None of the above
23. Accountability is the liability created for the use of
- A. Authority  
B. Responsibility  
C. Accountability  
D. All of the above
24. The process of co-ordination must begin in the early stages of
- A. Control  
B. Planning  
C. Organizing  
D. Staffing
25. The premises which can be controlled by the management are known as
- A. Internal premises  
B. External premises  
C. Controllable premises  
D. Tangible premises
26. Which of the following is not an agency cost?
- A. Residual loss  
B. Bonding costs  
C. Concurrent loss  
D. Monitoring costs
27. Introduction of a person to the job and the organization is called
- A. Induction  
B. Placement

- C. Orientation  
D. None of the above
28. Which of the following are the methods of off-the-job training?  
A. Role playing  
B. Case studies  
C. Lectures and classroom instruction  
D. All of the above
29. Selection of language in which the message is to be given is called  
A. Medium  
B. Decoding  
C. Encoding  
D. Feedback
30. Informal means of circulating the information is called as  
A. Grapevine  
B. Verbal  
C. Horizontal  
D. Written

**Answer:**

1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
C	A	B	C	C	D	A	B	C	A	C	B	C	B	B
16	17	18	19	20	21	22	23	24	25	26	27	28	29	30
C	D	C	A	C	B	B	A	B	C	C	A	D	C	A

*So friends,*

*Hope you have enjoyed the mock test throughout. I hope you are studying the SELF LEARNING MATERIAL thoroughly. If you do, this mock test will be a cake-walk for you. Please maintain a record of your performance in all the mock tests. That will indicate your progress in this paper. Of course you should not consult the KEY before you finish off solving the test paper.*

*Wish you all the best !!!*

# CMA INTERMEDIATE COURSE

Syllabus 2022

## Topic

Module 12:  
Companies Act,  
2013

INTERMEDIATE

Group I - Paper-5

Business Laws and  
Ethics (BLE)

## THE CAPTAIN OF THE SHIP: DIRECTORS UNDER THE COMPANIES ACT, 2013

Company law is based on the legal fiction that a company constitutes a separate legal entity capable of owning property, initiating legal proceedings, and being sued. However, companies, unlike natural persons, lack the capacity to make decisions or execute transactions independently. Directors, serving as human agents, act on behalf of the company and represent its decision-making authority. The Companies Act, 2013 (hereinafter, “the Act”) dedicates an entire chapter to directors, highlighting their central role in corporate governance. The effectiveness of corporate governance is largely determined by the character and competence of the directors.

### Who is a Director?

Section 2(34) of the Act defines a director as a person appointed to the Board of Directors of a company. While concise, this definition encompasses a complex and multifaceted role. Directors are not simply functionaries; the Supreme Court of India in *Shri Ram Pistons & Rings Ltd. v. CIT (1993)* recognized that directors occupy a fiduciary position similar to that of trustees over the company’s assets. Directors are required to act in the collective interests of shareholders, creditors, employees, and society, rather than for personal gain.

### Minimum and Maximum Strength of the Board

The Act establishes a structured framework for board composition. Public companies must have a minimum of three directors, private companies require at least two, and a One Person Company (OPC) must have at least one director. The maximum number of directors is set at 15, but this limit may be exceeded by passing a special resolution, enabling companies to expand their boards as business complexity increases. Additionally, the mandatory appointment of at least one woman director in specified categories of companies is a notable provision. Rule 3 of the Companies (Appointment and Qualification of Directors) Rules, 2014, requires compliance by listed companies and certain public companies. This mandate advances boardroom diversity through enforceable legal standards.

### Residential Director Requirement

Section 149(3) requires every company to appoint at least one director who has resided in India for a minimum of 182 days during the preceding calendar year. This provision ensures that at least one director remains physically present in India, accessible to regulatory authorities, and accountable under Indian law. For multinational corporations with global executives, this requirement maintains the company’s connection to Indian jurisdiction.

### Independent Directors (IDs)

The introduction of Independent Directors (IDs), governed by Sections 149(4) through 149(12) and Schedule IV (Code for Independent Directors), constitutes a significant advancement in the Act. Listed public companies must have at least one-third of their directors as independent directors, and this requirement also applies to unlisted public companies that meet specified thresholds. An independent director is defined as an individual who has no material financial relationship with the company, is not related to promoters or senior management, and provides an external perspective to board deliberations. The maximum tenure for an independent director is two consecutive terms of five years each, followed by a mandatory three-year cooling-off period before reappointment.

### Case Study: Satyam Scandal and the Role of Independent Directors

*The Satyam Computer Services fraud of 2009 exposed the limitations of independent directors. Despite the presence of distinguished board members, the board failed to detect or challenge the extensive falsification of accounts by promoter-chairman Ramalinga Raju. In response, the Companies Act, 2013 introduced more stringent regulations for independent directors, including the establishment of a Data Bank (managed by the Indian Institute of Corporate Affairs), mandatory proficiency assessments, and explicit duties and liabilities. The legal implication is that formal independence must be accompanied by substantive independence in practice.*

### Appointment, Qualification and Disqualification

A director is required to obtain a Director Identification Number (DIN), issued by the Central Government under Section 154, prior to appointment. The DIN serves as a unique identifier that is essential for ensuring corporate accountability. Section 164 specifies grounds for disqualification, including insolvency, conviction for an offense involving moral turpitude, failure to file financial statements or annual returns for three consecutive years, and default in repayment of public deposits. The 2017 Amendment reinforced these provisions, resulting in the mass disqualification of directors from companies that failed to file financial statements for three years, and the Ministry of Corporate Affairs subsequently removed numerous dormant companies from the register.

### Resignation and Removal of Directors

A director may resign by submitting notice to the company in accordance with Section 168. The resignation becomes effective upon receipt or on a later date specified by the director. The company is required to notify the

Registrar using Form DIR-12 within 30 days. Section 169 governs removal, permitting a company to remove a director (except those appointed by the Tribunal) through an ordinary resolution, provided the director is afforded a reasonable opportunity to be heard.

### **Duties of Directors: Section 166**

Before Section 166, directors' duties were mainly defined by court judgments. Section 166 formally lists these duties in the Companies Act, 2013. Directors are required to act in accordance with the articles, act in good faith to advance the company's objectives for the benefit of all members, exercise reasonable care, skill, and diligence, avoid conflicts between personal and company interests, refrain from making secret profits, and not assign their office. Breach of these duties results in liability to the company and, in certain circumstances, to third parties.

### **Case Study: Tata Sons v. Cyrus Investments (2021)**

*The Supreme Court's judgment in this case offered significant insights into directors' duties and responsibilities. The removal of Cyrus Mistry as Chairman and Executive Director of Tata Sons in 2016 resulted in litigation that scrutinized director conduct and board decision-making processes. The Supreme Court upheld the removal, underscoring the importance of fiduciary duties, robust board procedures, and the balance of power between promoters and professional directors in closely held public companies.*

### **Powers of the Board: Section 179**

The Board of Directors manages the company by passing resolutions at duly convened meetings. Section 179(3) enumerates powers that may only be exercised by the Board at a meeting, rather than by circular resolution. These powers include making calls on unpaid share capital, authorizing buybacks, issuing securities, approving financial statements, diversifying business operations, acquiring other companies, and approving amalgamations. This requirement prevents the concentration of authority in a single director or officer.

### **Remuneration of Directors**

Section 197, read with Schedule V governs managerial remuneration in public companies. Total remuneration for managing directors, whole-time directors, and managers must not exceed 11% of net profits. Individual limits are set at 5% of net profits for a managing director or whole-time director, or 10% collectively for two or more such directors. In years with inadequate or no profit, remuneration may be paid within Schedule V limits, subject to special resolution approval in certain cases. The 2020 amendment to the Act increased flexibility for remuneration during loss years, contingent on shareholder approval.

### **Board Meetings: Sections 173 and 174**

The initial board meeting must be held within 30 days of company incorporation. Thereafter, at least four board meetings are required annually, with no interval exceeding 120 days between meetings. Each meeting must be preceded by at least seven days' notice, although shorter notice is permitted in urgent situations. The quorum for board meetings is one-third of the total strength or two directors, whichever is greater. The use of video conferencing for board meetings, which became standard during the COVID-19 pandemic, has now been permanently adopted.

### **Conclusion**

The quality of corporate governance in India has improved significantly since the implementation of the Act. Mandatory disclosures, the DIN system, the IICA proficiency test for independent directors, and enhanced penal provisions have fostered a culture of increased accountability. For CMA professionals, understanding the role of directors is essential for effective practice. In their capacities as advisors, cost auditors, or management consultants, they frequently interact with boards, provide governance advice, and identify compliance issues. A well-governed board, led by directors who diligently fulfill their duties, forms the foundation of a sustainable enterprise.

## RUNNING THE ENGINE ROOM: KEY MANAGERIAL PERSONNEL UNDER THE COMPANIES ACT, 2013

A well-governed company operates with two main layers of authority. The Board of Directors sets strategy and holds ultimate accountability. Between board decisions and daily operations is a crucial middle tier: senior professionals who manage the company's day-to-day activities. The Companies Act, 2013, formalized this group as Key Managerial Personnel (KMP), extending statutory accountability beyond the board and establishing shared responsibility among operational leaders.

### Statutory Definition: Section 2(51)

Section 2(51) of the Companies Act, 2013, defines Key Managerial Personnel as including: (i) the Chief Executive Officer (CEO), or the Managing Director, or the Manager; (ii) the Company Secretary; (iii) the Whole-Time Director; (iv) the Chief Financial Officer (CFO); and (v) other officers as prescribed. In a One Person Company, it refers to its sole director.

This definition is significant because it elevated roles previously governed by contract or convention to statutory positions with defined responsibilities, accountability, and penalties. The CFO's inclusion introduced new legal accountability, fundamentally changing the compliance landscape.

### Mandatory Appointment: Section 203

Section 203 is central to KMP regulation. Every listed company and every public company with a paid-up share capital of ten crore rupees or more must appoint a whole-time KMP. This requires appointing a Managing Director or CEO, a CFO, and a Company Secretary. The section also prohibits any individual from serving as Managing Director or CEO in two companies simultaneously, with limited exceptions.

Any KMP vacancy must be filled within six months. Appointing a Managing Director, Whole-Time Director, or Manager requires Board approval and, in some cases, shareholder approval. The Board appoints the CFO and Company Secretary. All appointments must be reported to the Registrar within 60 days using Form MR-1 for managerial positions.

### The Managing Director: Cornerstone of Operations

Section 2(54) defines a Managing Director (MD) as a director with substantial powers to manage the company's affairs, but always under the Board's supervision and direction. The MD manages operations but remains accountable to the Board.

An MD can be appointed for a maximum term of five years. An MD may be appointed for a maximum term of five years, with the option for renewal. No individual

may serve as MD or Whole-Time Director in more than two companies simultaneously, preventing excessive concentration of management power. The MD's remuneration is governed by Schedule V and Section 197, which cap managerial pay relative to net profits.

### Case Study: Yes Bank and the MD Overstay

*The Reserve Bank of India's intervention in Yes Bank in 2020 raised questions about management accountability. Rana Kapoor, the MD and CEO, misused his position through related-party transactions that were against the bank's interests. His case reinforced why statutory limits on MD tenure and powers matter, and why KMP appointments need substantive regulatory oversight. While banks are also governed by RBI regulations, the lesson for Companies Act governance is the same: unchecked managerial power causes institutional harm.*

### The Company Secretary: Guardian of Compliance

Among KMPs, the Company Secretary (CS) has a particularly multidimensional role. Sections 203 and 205 govern the CS, who serves as an officer, compliance manager, Board advisor, and liaison to regulatory authorities.

Section 205 details the Company Secretary's duties, including reporting to the Board on compliance with the Act, rules, and other laws. The CS ensures adherence to secretarial standards issued by ICSI, guides directors on their responsibilities, assists with Board and general meetings, and maintains statutory registers and records.

The 2020 Amendment requires listed entities to submit an Annual Secretarial Compliance Report to stock exchanges, in addition to the secretarial audit report. This has made the CS's role even more central to listed company governance.

### The Chief Financial Officer: Where Finance Meets Accountability

The CFO's inclusion as KMP under the 2013 Act was a significant change, making a finance professional legally responsible for a company's financial integrity. Section 134 requires the CFO, MD, and at least one director to sign the financial statements. If appointed, the CS also signs. This joint signing establishes shared legal accountability.

The Audit Committee, established under Section 177, reviews the CFO's appointment, removal, and remuneration. The CFO must also provide a statement in the Board's Report under Section 134(5), confirming that the financial statements present a true and fair view and that internal financial controls are effective.

**Case Study: IL&FS and the CFO's Accountability**

*The collapse of IL&FS in 2018 exemplified governance failure in India. Financial risks were not properly disclosed to the Board or the public. Section 134(5) holds the CFO responsible for certifying internal financial controls, but this obligation was not fulfilled. Regulatory actions and NCLT proceedings reinforced that a CFO's signature on financial statements entails real accountability. The key lesson for aspiring CMAs is that financial leadership requires ethical accountability.*

**Whole-Time Director: The Executive Backbone**

A Whole-Time Director (WTD), as defined in Section 2(94), is a director employed full-time by the company. Unlike non-executive directors, who provide strategic guidance, a WTD manages daily operations and serves as a link between the Board and functional heads. In large manufacturing companies, a WTD often leads key functions such as operations, technology, or HR. Their remuneration is governed by Schedule V and Section 197.

**Secretarial Audit: Accountability of KMPs Verified**

Section 204 requires every listed company and qualifying public company to obtain a Secretarial Audit Report from a Practising Company Secretary, using Form MR-3. This report covers compliance with the Companies Act, the Depositories Act, SEBI regulations, and other laws. The

Board's Report must address any issues or qualifications noted in the Secretarial Audit Report, creating a feedback loop that directly involves KMPs.

**Penalties for Non-Compliance**

The Act both defines and empowers KMPs, while also holding them accountable. Several sections specify penalties for KMPs and companies. For example, Section 203(5) imposes fines on companies for breaches of KMP appointment requirements and fines each defaulting director and KMP daily, up to a maximum. The Companies (Amendment) Act, 2019, revised several penalties, converting some from criminal to civil offenses, but personal accountability for KMPs remains unchanged.

**Conclusion**

Corporate law textbooks often emphasize structures rather than people, but effective corporate governance depends on individuals. KMPs are central to a company's success or failure. The Companies Act, 2013, established a formal statutory framework for KMPs, defining their duties, appointments, and personal accountability. This recognition made previously overlooked roles visible. For corporate law students, KMP provisions are more than academic topics; they illustrate how modern corporate India ensures accountability among key functionaries.

## Topic

Module 3:  
Preparation of  
Final Accounts  
of Commercial  
Organisations,  
Not-for-Profit  
Organisations and  
from Incomplete  
Records

## INTERMEDIATE

### Group I - Paper-6

### Financial Accounting (FA)

## Preparation of Financial Statements of Commercial Organisations and Preparation of Financial Statements of Not-for-Profit Organisation

### Preparation of Financial Statements of Commercial Organisations

Preparation of financial statements for commercial organizations is a vital aspect of financial reporting and provides a comprehensive view of a company's financial performance, position, and cash flows.

Preparing financial statements for commercial organizations involves several key steps and considerations.

**Gather Financial Data:** Collect all relevant financial information including transactions, receipts, invoices, bank statements, etc.

**Organize Transactions:** Categorize transactions into appropriate accounts such as assets, liabilities, equity, revenue, and expenses.

**Recording Transactions:** Enter transactions into the accounting system. This could be done manually or using accounting software like QuickBooks or Xero.

**Adjusting Entries:** Make any necessary adjusting entries to ensure that revenues and expenses are recorded in the correct accounting period and that assets and liabilities are properly recognized.

**Prepare Trial Balance:** Create a trial balance to ensure that debits and credits are equal and the books are in balance.

### Prepare Financial Statements:

**Income Statement (Profit and Loss Statement):** Summarizes revenues and expenses over a period of time to determine the company's profitability.

**Balance Sheet:** Presents the company's financial position at a specific point in time, showing assets, liabilities, and equity.

**Cash Flow Statement:** Reports cash generated and used by operating, investing, and financing activities during a period.

**Statement of Changes in Equity (if applicable):** Shows changes in equity during the reporting period, including shareholder transactions and changes in retained earnings.

**Analysis and Interpretation:** Analyze the financial statements to assess the company's financial health, performance, and liquidity. Look for trends, ratios, and other indicators to understand the company's strengths and weaknesses.

**Disclosure and Presentation:** Ensure that the financial statements comply with relevant accounting standards (e.g., GAAP, IFRS) and include all necessary disclosures and footnotes.

**Review and Audit:** Review the financial statements for accuracy and completeness. In some cases, an external audit may be required by regulatory authorities or stakeholders.

**Distribution and Communication:** Share the financial statements with stakeholders such as investors, creditors, management, and regulatory bodies as required.

It's essential to follow accounting principles and standards relevant to your jurisdiction and industry while preparing financial statements to ensure accuracy, transparency, and compliance. Additionally, seeking assistance from accounting professionals or consultants can be beneficial, especially for complex accounting issues or regulatory requirements.

### Preparation of Financial Statements of Not-for-Profit Organisation

Preparing financial statements for a not-for-profit (NFP) organization involves similar steps to those for commercial organizations, with some key differences due to the nature of NFP operations. Here's an overview tailored to NFPs:

**Gather Financial Data:** Collect all financial information including donations, grants, program revenues, expenses, and other income sources.

**Organize Transactions:** Categorize transactions into appropriate accounts such as contributions, program expenses, administrative expenses, fundraising expenses, and investment income.

**Recording Transactions:** Enter transactions into the accounting system, ensuring accurate recording of all income and expenses related to the organization's activities.

**Adjusting Entries:** Make any necessary adjustments to ensure that revenues and expenses are recorded correctly and in accordance with generally accepted accounting principles (GAAP) for not-for-profit organizations.

**Prepare Trial Balance:** Create a trial balance to verify that debits and credits are equal and that the accounting records are in balance.

### Prepare Financial Statements:

**Statement of Financial Position (Balance Sheet):** Presents the organization's assets, liabilities, and net assets (equity) at a specific point in time.

**Statement of Activities (Income Statement):** Summarizes revenues and expenses for a period, showing the organization's financial performance.

**Statement of Cash Flows:** Reports cash inflows and outflows from operating, investing, and financing activities during the reporting period.

**Statement of Functional Expenses:** Breaks down expenses by function (e.g., program services, management and general, fundraising) to provide transparency on how resources are utilized.

**Analysis and Interpretation:** Analyze the financial statements to assess the organization's financial health, efficiency in resource utilization, and sustainability. Evaluate key ratios and metrics relevant to not-for-profit organizations, such as program expense ratios and fundraising efficiency ratios.

**Disclosure and Presentation:** Ensure that the financial statements comply with applicable accounting standards for not-for-profit organizations, such as the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 958, and include all required disclosures and footnotes.

**Review and Audit:** Review the financial statements for accuracy and completeness. Depending on regulatory requirements and organizational policies, an external audit may be conducted to provide assurance to stakeholders.

**Distribution and Communication:** Share the financial statements with stakeholders such as donors, grantors, board members, and regulatory bodies as required. Transparent communication of financial information is crucial for maintaining trust and accountability in the organization.

It's essential for not-for-profit organizations to adhere to accounting standards specific to their sector and to accurately report on the allocation of resources towards achieving their mission and objectives. Seeking guidance from accounting professionals with expertise in not-for-profit accounting can ensure compliance and effective financial management.

### **Importance of preparation of Financial Statements for Commercial Organisations and Not-for-Profit Organisations:**

The preparation of financial statements holds significant importance for both commercial organizations and not-for-profit (NFP) organizations, albeit with some differences in their objectives and stakeholders. Here's a comparison of their importance:

#### **Commercial Organizations:**

**Decision Making and Investor Confidence:** Financial statements provide crucial information for decision-making by investors, creditors, suppliers, customers, and management in commercial organizations. Investors rely on financial statements to assess profitability, growth potential, and risks before making investment decisions. Transparent financial reporting enhances investor confidence and facilitates access to capital markets.

**Creditworthiness and Financing:** Financial statements play a vital role in determining a company's creditworthiness

and ability to obtain financing from banks, financial institutions, and other creditors. Lenders analyze financial statements to evaluate the company's ability to repay loans, manage debt, and generate cash flows. Positive financial performance enhances the company's borrowing capacity and access to favourable financing terms.

**Regulatory Compliance and Taxation:** Commercial organizations are required to prepare financial statements in compliance with accounting standards and regulatory requirements, such as GAAP or IFRS. Accurate financial reporting ensures compliance with tax laws and facilitates tax planning strategies. Financial statements serve as the basis for tax assessment, auditing, and regulatory reporting.

**Performance Evaluation and Benchmarking:** Financial statements enable stakeholders to evaluate the company's financial performance, profitability, efficiency, and competitiveness over time. Comparative analysis with industry peers and benchmarks helps assess relative strengths and weaknesses and identify areas for improvement. Financial ratios and metrics derived from financial statements facilitate performance evaluation and benchmarking against industry standards.

**Transparency and Accountability:** Transparent financial reporting promotes accountability and integrity in commercial operations by providing stakeholders with clear, accurate, and timely information about the company's financial position and performance. Disclosure of significant accounting policies, assumptions, estimates, and risks enhances transparency and allows stakeholders to make informed decisions based on reliable financial information.

#### **Not-for-Profit Organizations:**

**Stakeholder Trust and Accountability:** Financial statements for NFP organizations are crucial for maintaining trust and accountability with donors, grantors, members, volunteers, and other stakeholders. Donors and grantors rely on financial statements to assess the organization's financial health, governance, and stewardship of resources before making contributions.

**Transparency and Donor Confidence:** Transparent financial reporting demonstrates the NFP organization's commitment to accountability, ethical stewardship, and mission fulfillment. Donors and grantors expect clear and detailed financial statements that provide insights into how their contributions are utilized and the impact achieved by the organization's programs and services.

**Regulatory Compliance and Funding:** NFP organizations are subject to regulatory requirements and reporting obligations imposed by governmental authorities, funding agencies, and oversight bodies. Compliance with accounting standards and regulatory requirements ensures transparency, credibility, and eligibility for funding, grants, and tax-exempt status.

**Performance Evaluation and Impact Assessment:**

Financial statements enable stakeholders to evaluate the NFP organization’s financial performance, efficiency, and effectiveness in delivering programs and services. Comparative analysis of financial data over time and benchmarking against industry standards help assess progress toward mission objectives and identify areas for improvement.

**Mission fulfilment and Sustainability:** Financial statements provide insights into the NFP organization’s ability to achieve its mission, serve its beneficiaries, and sustain operations over the long term. Donors and stakeholders expect financial sustainability, prudent financial management, and accountability in the use of resources to ensure the organization’s continued impact and relevance.

In summary, while the preparation of financial statements is essential for both commercial organizations and NFP organizations, the specific objectives, stakeholders, and regulatory environments may vary. Transparent financial reporting fosters trust, accountability, and informed decision-making in both sectors, contributing to organizational success and societal impact.

**Questions:**

1. Which financial statement summarizes a company’s revenues and expenses over a specific period?
  - a) Balance Sheet
  - b) Income Statement
  - c) Cash Flow Statement
  - d) Statement of Changes in Equity
2. Which financial statement reports the cash inflows and outflows from operating, investing, and financing activities?
  - a) Balance Sheet
  - b) Income Statement
  - c) Cash Flow Statement
  - d) Statement of Changes in Equity
3. What is the purpose of adjusting entries in the preparation of financial statements?
  - a) To correct errors in the trial balance
  - b) To record transactions that were missed initially
  - c) To ensure revenues and expenses are recognized in the correct accounting period
  - d) To adjust the cash balance
4. Which financial statement reports changes in equity, including transactions with shareholders and changes in retained earnings?

- a) Income Statement
- b) Balance Sheet
- c) Cash Flow Statement
- d) Statement of Changes in Equity
5. Which of the following is NOT a purpose of financial statements for commercial organizations?
  - a) Decision-making
  - b) Regulatory compliance
  - c) Stakeholder trust
  - d) Identifying donors
6. What does the balance sheet of a not-for-profit organization primarily represent?
  - a) Financial performance over a period
  - b) Cash inflows and outflows
  - c) Financial position at a specific point in time
  - d) Sources and uses of cash
7. What is the purpose of the statement of changes in net assets for a not-for-profit organization?
  - a) To disclose significant accounting policies
  - b) To summarize program expenses
  - c) To report changes in equity, including transactions with donors and changes in net assets
  - d) To present the organization’s financial position at a specific point in time
8. Which financial statement reports the organization’s financial position, including its assets, liabilities, and net assets at a specific point in time?
  - a) Income Statement
  - b) Balance Sheet
  - c) Cash Flow Statement
  - d) Statement of Functional Expenses
9. What is the primary purpose of financial statements for not-for-profit organizations?
  - a) Decision-making
  - b) Regulatory compliance
  - c) Stakeholder trust
  - d) Maximizing shareholder wealth
10. Which of the following is NOT a characteristic of financial statements for not-for-profit organizations?
  - a) Emphasis on transparency and accountability
  - b) Focus on profitability and return on investment
  - c) Presentation of financial position and performance
  - d) Disclosure of significant accounting policies and estimates

**Answer:**

1	2	3	4	5	6	7	8	9	10
b	c	c	d	d	c	c	b	c	b

## Topic

Module 2:  
Heads of Income

INTERMEDIATE

Group I - Paper-7A

Direct Taxation (DT)

## Income From Other Sources

Income from Other Sources serves as residuary head of income under the framework of the Income-tax Act, 1961. A receipt shall be taxable under this head if such income does not specifically fall under any one of the other four heads of income—namely, Salary, House Property, Profits and Gains of Business or Profession (PGBP), or Capital Gains. While Section 56(1) establishes this broad, catch-all principle to ensure no revenue escapes the tax net, Section 56(2) explicitly enumerates specific receipts that unconditionally fall under this category. This includes critical items such as dividends, casual incomes like winnings from lotteries and crossword puzzles, and various forms of gifts. Mastering this head requires a precise understanding of its dual nature: capturing leftover income while strictly regulating specific statutory receipts.

1. A receipt shall be taxable under this head if such income does not specifically fall under any one of the other four heads of income.
2. Basis of chargeability: Income under this head shall be chargeable on ‘accrual’ or ‘cash’ basis depending on the method of accounting regularly followed by the assessee.
3. Casual Income: Winning from lotteries, crossword puzzles, etc. are taxable under this head. Tax is charged on such income at a flat rate of 30% plus surcharge (if any) plus cess.
4. Income from letting of machinery, plant or furniture is charged to tax under this head, if such income is not chargeable under the head “Profits and gains of business or profession”.
5. Composite rent: If letting of building is inseparable from letting of machinery, furniture, etc. then income from such letting is charged to tax under the head “Income from other sources” otherwise Income from house property.
6. Family pension: It is taxable under the head “Income from other sources” after allowing standard deduction to the minimum of a) 1/3rd of such pension; or b) ₹ 25,000 (however, if the assessee has opted for old tax regime then ₹ 15,000).
7. Gift: Following receipts by any person shall be considered as his income:

Asset Type	Nature of Receipt	Taxability Trigger / Threshold	Amount Chargeable to Tax
₹ Sum of Money	Without Consideration	Aggregate amount received during the previous year exceeds ₹ 50,000	Entire aggregate amount received
🏠 Immovable Property (Land or Building)	Without Consideration	Stamp Duty Value (SDV) of the property exceeds ₹ 50,000	Entire Stamp Duty Value (SDV) of the property
🏠 Immovable Property (Land or Building)	For Inadequate Consideration	SDV exceeds consideration by an amount exceeding ₹ 50,000 and such excess exceeds 10% of the consideration	D i f f e r e n c e between SDV and consideration
💎 Movable Property (Shares, Securities, Jewellery, Archaeological Collections, Drawings, Paintings, Sculptures, Any Work of Art, Bullion, VDA, etc.)	Without Consideration	Aggregate Fair Market Value (FMV) of all such properties exceeds ₹ 50,000	Entire aggregate FMV of such properties
💎 Movable Property (Shares, Securities, Jewellery, Archaeological Collections, Drawings, Paintings, Sculptures, Any Work of Art, Bullion, VDA, etc.)	For Inadequate Consideration	Aggregate FMV exceeds aggregate consideration by an amount exceeding ₹ 50,000	Difference between aggregate FMV and aggregate consideration

🔊 **Exceptions: The receipt is fully exempt if the gift is received:**

- (a) From any relative; or
- (b) On the occasion of the marriage of the individual; or

- (c) Under a will or by way of inheritance / in contemplation of the death of the payer; or
- (d) From a local authority, registered trust, university, educational institution, or medical institution; or
- (e) By way of distribution at the time of total or partial partition of an HUF; or
- (f) Shares received in a consequence of demerger, amalgamation, or business reorganization of a co-operative society
8. Interest on securities is charged to tax u/s 56. However, if such securities are held as stock, then taxed u/s 28.
9. Interest on delayed receipt of compensation or enhanced compensation shall be taxable in the year of receipt after deducting standard deduction @ 50% of such income.
10. Bonus Stripping: Where any person acquires any unit (original unit) within a period of 3 months prior to the record date and is allotted bonus unit on such date and such person transfers original unit within a period of 9 months after such date, then any loss arising to him shall be ignored and the amount of loss so ignored shall be deemed to be the cost of acquisition of such bonus unit held by him on the date of such sale or transfer.
11. Dividend: As per sec. 2(22),
- (a) Any distribution of accumulated profits, which results in the release of assets of the company.
- (b) Any distribution of Debenture, debenture-stock, deposit certificates in any form whether with or without interest to its shareholders (equity as well as preference); and Shares to preference shareholders by way of bonus, to the extent to which company possess accumulated profit.
- (c) Distribution made on liquidation to the extent to which company possess accumulated profit immediately before liquidation.
- (d) Distribution made on reduction of capital of the company to the extent it possess accumulated profit.
- (e) Any loan or advance by a company (in which public are not substantially interested) to the extent of accumulated profit (excluding capitalized profit) to its equity shareholder holding not less than 10% of voting power in the company or to a concern of which such shareholder is a member and has substantial interest in such concern or to any person on behalf of or for the benefit of such specified shareholder.

Tax treatment: Dividend or income from units shall be taxable in the hands of shareholders or unit holders at the applicable rate. No deduction shall be allowed from dividend income, or income in respect of units of mutual fund or specified company, other than deduction on account of interest expense and in any previous year. Further, such deduction shall not exceed 20% of the dividend income or income from units included in the total income for that year without this deduction [however, no deduction shall be allowed in case of buy back of shares]

12. Specific disallowance: The following expenditures shall not be deducted from any income under this head
- Any personal expenses of the assessee.
  - Any interest which is payable outside India on which tax has not been deducted at source.
  - Any salary payable outside India on which tax has not been deducted at source.
  - 30% of any payment made to a resident on which TDS provision is applicable without deducting TDS as referred u/s 40(a)(ia)
  - Any amount paid as Wealth tax or Income tax.
  - Any amount specified u/s 40A e.g. payment to relative in excess of requirement; or cash payment in excess of ₹ 10,000.
  - No deduction in respect of any expenditure shall be allowed in computing the income by way of any winnings from lotteries, etc.
13. Deemed Profits: Where an allowance or deduction has been allowed for any year in respect of loss, expenditure or trading liability incurred by the assessee; and subsequently, any amount is obtained, as revocation of such loss, expenditure or remission of liability, whether in cash or in any other manner, during any previous year, then such amount received or amount remitted shall be charged to tax.

The head 'Income from Other Sources' covers a wide range of incomes and frequently appears in exams due to its immense practical relevance. Far from being a mere residual category, it houses some of the most rigorous anti-avoidance provisions in the tax code, including the taxation of deemed dividends and the comprehensive gift tax mechanism u/s 56(2)(x). A clear understanding of what constitutes casual income, gift taxability, dividend income, and deemed incomes helps students master numerous problem-based questions. By successfully linking these concepts with permissible deductions u/s 57 and explicit disallowances u/s 58, students will build the statutory precision required to navigate complex scenarios.

## Advance Tax

Advance Tax, fundamentally anchored in the statutory philosophy of “pay as you earn,” is a mechanism designed to ensure that income tax is paid in the same financial year in which the income is earned. Under Section 208, it becomes mandatory for any taxpayer—whether a salaried individual, self-employed professional, freelancer, or corporate entity—whose estimated total tax liability for the financial year reaches ₹ 10,000 or more. Rather than delaying tax payments until the end of the year, the liability is distributed across prescribed quarterly installments. This system serves a dual purpose: it guarantees a continuous, predictable flow of revenue to the government for financial planning while preventing taxpayers from facing a heavy financial burden from lump-sum payments at the end of the financial year.

### Who Needs to Pay Advance Tax?

Advance Tax is mandatory for:

- **Salaried individuals:** Salaried individuals who have income from sources other than salary such as rent, interest, capital gains, etc., need to pay advance tax.
- **Freelancers and self-employed individuals:** Individuals earning income from business or profession.
- **Companies:** Corporate taxpayers and businesses.
- **Others:** Any individual earning from dividends, capital gains, lottery winnings, or similar incomes.

However, a senior citizen (aged 60 years or above) who does not have income from business or profession is exempted from paying advance tax.

### Due Dates and Installments

The Income Tax Department has prescribed specific due dates for the payment of advance tax. The payments can be made in four installments throughout the financial year:

1st Installment	By June 15	15% of the advance tax liability
2nd Installment	By September 15	45% of the advance tax liability (cumulative)
3rd Installment	By December 15	75% of the advance tax liability (cumulative)
4th Installment	By March 15	100% of the advance tax liability (cumulative)

**Exception:** For taxpayers who have opted for the presumptive taxation scheme u/s 44AD or 44ADA of the Income Tax Act, the entire advance tax liability has to be paid by March 15 in one installment.

### Calculation of Advance Tax

Advance tax can be calculated using the following steps:

- **Estimate your total income:** Calculate the total income from all sources (salary, rent, business, capital gains, etc.) for the financial year.
- **Calculate gross taxable income:** Adjust the total income by considering deductions available under various sections of the Income Tax Act (such as Section 80C, 80D, etc.).
- **Compute tax liability:** Apply the applicable income tax rates to the gross taxable income to compute the tax liability.
- **Deduct TDS and other credits:** Subtract the Tax Deducted at Source (TDS) and any other tax credits available.
- **Determine advance tax liability:** If the net tax liability is ₹10,000 or more, then advance tax has to be paid as per the specified due dates.

### Interest on Late Payment of Advance Tax

Under Sections 234B and 234C of the Income Tax Act, interest is charged for the late payment or short payment of advance tax:

- **Section 234B:** Interest is charged if the taxpayer has not paid 90% of the tax liability or has paid less than the prescribed percentage of advance tax within the previous year. The interest is charged at 1% per month from April 1 of the assessment year till the date of actual payment.

- **Section 234C:** Interest is charged for default in payment of each installment. It is calculated at 1% per month for the period of delay on the amount of shortfall.

### Adjustment and Refund

Advance tax paid during the financial year is adjusted against the total tax liability at the time of filing the annual income tax return. If the advance tax paid is more than the actual tax liability, the excess amount is refunded to the taxpayer with interest u/s 244A

### Importance of Advance Tax

- **Regular Revenue Flow:** It ensures a regular inflow of revenue to the government, helping in better financial planning and implementation of developmental projects.
- **Reduced Year-End Burden:** For taxpayers, it spreads the tax payment over the year, reducing the financial burden at the end of the financial year.
- **Compliance:** Paying advance tax on time helps in avoiding interest for non-compliance.
- **Tax Planning:** It helps in better tax planning and managing cash flows effectively.

### Advance Tax for Specific Incomes

- **Capital Gains and Dividends:** Taxpayers with capital gains or dividends can pay advance tax in the remaining installments after the income arises.
- **Income from Lottery, Horse Races, etc.:** Advance tax (after considering TDS, if any) on such incomes should be paid immediately after earning the income.
- **Business Income:** Individuals with business income need to estimate their profits accurately to determine the advance tax liability.

### Conclusion

Advance Tax is a crucial component of the income tax system in India, designed to ensure timely payment of taxes and efficient revenue collection for the government. For students and practitioners alike, mastering this chapter requires more than just memorizing due dates and percentages; it demands a thorough understanding of the strict interest levied u/s 234B and 234C for short-payments or defaults. By accurately estimating diverse income streams and tracking relevant exceptions like the resident senior citizen exemption u/s 207, taxpayers can remain fully compliant. Ultimately, proper calculation and timely payment of advance tax reflect good financial discipline and compliance with tax laws, eliminating costly interest liabilities during the assessment process.

## Topic

Module 5:  
Goods and Services  
Tax (GST) Laws

INTERMEDIATE

Group I - Paper-7B

Indirect Taxation  
(IDT)

## Tax Invoice

Under the GST regime, a tax invoice is far more than a mere commercial instrument; it is the most crucial statutory document that formalizes the transaction between a supplier and a recipient. It serves a vital dual purpose: it acts as the primary evidence of a supply and forms the absolute legal basis for a recipient to avail Input Tax Credit (ITC). In fact, a registered person is strictly barred from claiming ITC unless they are in possession of a valid tax invoice or debit note. Furthermore, the issuance of this document is deeply intertwined with the ‘time of supply’ provisions, effectively dictating exactly when the liability to pay GST to the government arises. For students, mastering the statutory contents, specialized types, and strict timelines of these documents is essential for understanding how transparency, traceability, and compliance are maintained within the indirect tax framework.

### Introduction to Tax Invoices under GST

A tax invoice is a cornerstone document within the GST framework. Its significance extends beyond merely recording a commercial transaction; it serves as the statutory foundation for critical compliance requirements:

- **Primary Evidence for ITC:** It is the definitive proof of a supply of goods or services. The law strictly prohibits a registered recipient from availing Input Tax Credit (ITC) unless they possess a valid tax invoice or a debit note.
- **Determinant of Time of Supply:** GST liability is triggered at the “time of supply,” making the invoice date a crucial indicator. While the general rule determines the time of supply as the earlier of the invoice issuance or payment receipt, a special procedure applies to the supply of goods. For registered suppliers of goods (excluding composition dealers), GST is payable strictly based on the date of invoice issuance, regardless of when the payment is received.

The GST Law mandates that an appropriate document—whether a tax invoice or a bill of supply—must be issued within prescribed timelines whenever a supply occurs, covering every form such as sale, transfer, barter, exchange, license, rental, lease, or disposal. While the statute does not prescribe a rigid, standardized layout or format for the invoice, it strictly mandates that specific fields and particulars must be incorporated. This chapter explores these mandatory contents, the various types of documents required under GST law, and their statutory issuance timelines.

### Significance of Tax Invoices

Tax invoices serve several important purposes in the GST

framework:

- **Legal Compliance:** Tax invoices are mandated by law under the GST regime, and failure to issue proper invoices can lead to penalties and legal consequences.
- **Input Tax Credit (ITC):** Tax invoices are necessary for claiming ITC, as they provide evidence of tax paid on inputs and input services used in the course of business.
- **Audit and Verification:** Tax authorities rely on tax invoices to audit and verify the accuracy of tax returns filed by taxpayers, ensuring compliance with GST laws and regulations.

### Key Components of a Tax Invoice

A tax invoice under GST must contain specific details to be considered valid. These include:

- **Supplier’s Details:** Name, address, GSTIN (Goods and Services Tax Identification Number), and State code of the supplier.
- **Recipient’s Details:** Name, address, GSTIN (if registered), and State code of the recipient.
- **Invoice Number and Date:** A consecutive serial number and date of issue of the invoice.
- **Description of Goods or Services:** Details such as quantity, unit price, total value, and applicable GST rate for each item supplied.
- **Taxable Value and Tax Amount:** Separate disclosure of the taxable value, CGST (Central Goods and Services Tax), SGST (State Goods and Services Tax), IGST (Integrated Goods and Services Tax), and cess, if applicable.
- **Place of Supply:** Indicates whether the supply is intra-state (within the same state) or inter-state (between different states).
- **Shipping and Billing Address:** If different from the supplier’s and recipient’s addresses.
- **Payment Terms:** Terms and conditions of payment, including payment due date and mode of payment.

### Types of Tax Invoices

Under GST, there are different types of tax invoices based on the nature of the transaction:

- **Tax Invoice:** Issued for taxable supplies of goods or services.
- **Bill of Supply:** Issued when GST is not applicable or when the supplier is registered under the composition scheme.

- **Credit Note:** Issued to reduce the taxable value or tax amount in case of goods returned or services cancelled.
- **Debit Note:** Issued to increase the taxable value or tax amount due to additional goods supplied or services provided.

**Timeline for issuance of invoice**

In general, time of issue of tax invoice for:

- **Supply of Goods:** A registered person supplying taxable goods shall issue a tax invoice, before or at the time of:

Where the supply involves the movement of goods	Removal of goods for supply to the recipient
Where the supply does not involve the movement of goods	Delivery of goods or making available thereof to the recipient

- **Supply of Services:** Invoice is required to be issued within 30 days from the date of the supply of service. However, in the case of an insurance/banking company or a financial institution, including NBFC, the invoice is required to be issued within 45 days

**Implications for Businesses and Taxpayers**

For businesses and taxpayers, compliance with tax invoice requirements under GST is crucial for several reasons:

- **Input Tax Credit (ITC) Claim:** Proper maintenance

and issuance of tax invoices enable businesses to claim ITC, reducing the overall tax liability.

- **Audit and Assessment:** Tax authorities may conduct audits or assessments based on tax invoices to verify the accuracy of tax returns and ensure compliance with GST laws.
- **Legal Compliance:** Failure to issue valid tax invoices or maintain proper records can lead to penalties, interest, and other legal consequences.
- **Business Relationships:** Clear and accurate tax invoices enhance transparency and trust in business transactions, fostering better relationships with customers and suppliers.

**Conclusion**

Ultimately, tax invoices form the undisputed backbone of GST compliance. By meticulously documenting taxable transactions and enabling the seamless flow of Input Tax Credit, proper invoicing ensures that the cascading effect of taxes is effectively eliminated. For taxpayers and businesses, the correct issuance and maintenance of these records do far more than support accurate return filing; they act as a critical safeguard against departmental disputes, heavy penalties, and rigorous audit scrutiny. Developing a sound, section-based understanding of these invoicing requirements—from standard tax invoices to specialized bills of supply and alternative vouchers—ensures robust compliance discipline and builds a strong, practical foundation for any aspiring tax professional.

## Topic

Module 6:  
Cost Accounting  
Techniques

INTERMEDIATE

Group I - Paper-8

Cost Accounting  
(CA)

## Budget and Budgetary Control

Budget is a plan expressed in monetary terms. It is prepared and approved prior to the budgeted period and may show income, expenditure and the capital to be employed. It may also draw up showing incremental effects on formal budgeted or actual figures or be complied by zero-based budgeting.

Budgetary Control is the establishment of budgets relating to responsibilities of executives to the requirement of a policy and the continuous comparison of actual with budgeted results either to secure by individual action the objective of the policy or to provide a basis for revision.

Steps required for an efficient budgetary control system:

1. Dividing the organization according to function, known as budget centre.
2. Preparation of separate budget for each centre.
3. Coordination between the centers for establishing the responsibilities.
4. Measurement of actual performances.
5. Composition of actual performance with the budget in order to develop the deviations. Six analyse the variance is into its possible causes for motivating the right people to take right decisions and action in proper time.
6. Taking remedial measures to readjust the budgeted estimates.

### Budget Centre:-

It is an area or section of an organization for which control may be exercised and budget is prepared. Budget, which refers to a budget Centre, is a departmental budget. A budget Centre may consist of number of cost centers.

### Budget Committee:-

A budget committee is a committee to formulate a general program for preparing budget and to exercise overall control. As budgeting aims at coordination of activities. The main functions of the budget committee is to reconcile divergent views, to coordinate and finally to submit proposals for approval by the top executives.

### Budget Period:-

The budget period may be defined as the period for which budget is prepared and used for controlling actual performances. In fact, there is no fixed period and the budget period varies according to requirements of the organization.

### Budget Manual:-

Budget manual is a schedule or document setting out the responsibilities of the person engaged in, the routine of,

and the forms and records required for budgetary control. It serves as a guide for departmental heads.

### Budget Factor:-

Budget factor is the factor whose influence must fast be assisted in order to ensure that functional budgets are responsibly capable of fulfillment. Often sales is the budget factor, but the other factor, such as men, materials, machines, capital, etc. May also act as budget factor.

### Functional Budget:-

It is a budget of income and expenditures that relates to any of the functions of an organization. There are various types of functional budgets depending on the size and policy of the organization. The budgets which are prepared frequently are:

#### 1. Sales Budget:-

Sales budget is a quantitative statement of future sales of an organization expressed in monetary terms. It is the most important functional budget, as sales are the key factor of an organization.

#### 2. Production Budget:-

It is a forecast for the quantities to be produced in a period for achieving the sales target. It may be prepared in terms of units or standard hours.

#### 3. Capital Expenditure Budget:-

It is a plan for proposed outlay on fixed assets during the budget period. The Capital expenditure budget is fast prepared on long-term basis keeping in view the potential demand for product, existing capacity of production and long-term business policy.

#### 4. Personal Budget:-

This budget is prepared to show the planned outlay on direct and indirect labor cost during the budget period as well as to show the number of skilled, semiskilled and skin manpower required to fulfill the production.

#### 5. Purchase Budget:-

This budget is prepared to show the materials to be brought during the budget period. This budget helps the organization in setting out the money required to purchase direct and indirect materials required for production or to purchase finish goods for trading operations. It is prepared showing quantity to be bought and its value.

#### 6. Selling and Distribution Cost Budget:-

This is prepared to show the estimated overhead expenses in sales and distribution to the goods to be

sold during the budget period. It is prepared on the basis of sales budget, as it shows the cost quantities on sales budget.

Distribution expenses include the cost for handling the order, after sales service, expenditures, storage, outward, freight, credit collection, expenses, packing, export duty, insurance, etc. After consolidation of all these estimates, the final selling and distribution cost budget is to be presented to the budget committee for its approval.

#### 7. Production Cost Budget: -

It is the forecast of the estimated cost of production based on product production budget. It is actually the summary of material budget, labor, budget, factory overhead budget, and may be expressed by analyzing into its departments and or products.

#### 8. Plant Utilization Budget:-

It is the budget closely connected with the production budget, which will show the estimated plant facilities required to meet the budgeted production. This enables one to estimate the number of machines required to be installed for production and at what time and for which production. The budget can be expressed in terms of working hours or in any other suitable units.

#### 9. Administration Cost Budget:-

Administration cost budget is the budget showing the estimated cost of formulating the policies, directing the organization and controlling the operation of an undertaking. Administrative costs are mainly fixed in nature for a given period of time.

An example of Cash Budget is given below.

#### Problem:

AB and Co. commences business on 1st July 2026 and deposits ₹10,000 in the bank. This amount will be inadequate to finance its operations over a period of six months and you are asked to prepare a Cash Budget up to 31st December 2026. to determine the monthly overdraft units to seek from the Company's bankers.

The data furnished to you are :-

- 1) Minimum cash balance to be maintained ₹500
- 2) Plant purchases are made on net thirty days terms and cheques are paid to creditors on the last day of the month due.
- 3) The budget figures are:

	July (₹)	Aug(₹)	Sep.(₹)	Oct.(₹)	Nov.(₹)	Dec.(₹)
Purchases	5000.	4000.	3000.	4000.	4000.	5000
Wages.	4000.	5000.	4000.	4000	5000	4000
Cash Expenses	400.	500.	400.	400.	500.	400
Sales.	6000.	7000	8000	8000.	9000.	12000

You are asked to interpret the results as shown by preparation of Cash Budget.

#### 10. Research and Development Cost Budget:-

The Research and development cost budget is planned outlay on research and development for a given period. It helps in coordination with other plans and programmers of an organization. The budget will show the permissible limit within which the activities are to be pursued.

#### 11. Cash Budget:-

It is the budget that forecast the cash receipts and payments for a given period. This budget is prepared after the preparation of all functional budgets. For efficient running of an organization, the anticipated cash requires should be known in advance.

#### 12. Master Budget:-

It is a budget, which is the summary of all functional budgets of an organization. It includes:

Budgeted, profit and loss account, budgeted, profit and loss, appropriation account, budgeted balance sheet, and budgeted cash flow statement. Budgeted costs are classified and summarized by types of expenses as well as by departments.

#### 13. Flexible Budget:-

A flexible budget has been defined as a budget which is designed to change in accordance with the activities attended. Particularly it is a series of budgets for different levels of activities. Here costs are analyzed, behaviourwise, Viz., Variable, Fixed and semi variable expenses.

Solution:

Cash Budget for the months from July to December 2026

Particulars	July.(₹)	Aug.(₹)	Sep.(₹)	Oct.(₹)	Nov(₹)	Dec (₹)
Opening Cash Balance	10000.	600.	500.	500.	500.	500
Receipts—Sales Collection	---	---	5820.	6790.	7760.	7760
Total A.	10000.	600	6320.	7290.	8260.	8260
<b>Payments.:</b>						
Creditors	----	5000	4000.	3000.	4000.	4000
Wages	4000.	5000.	4000.	4000.	5000.	4000
Expenses	400.	500.	400.	400.	500.	400
Plant	5000	-----	-----	-----	-----	-----
Total payments B	9400.	10500.	8400.	7400	9500	8400
A – B = C	600	(9900).	(2080)	(110).	(1240).	(140)
<b>Overdraft to be taken :</b>						
D = C + ₹500	-----	10400.	2580.	610	1740.	640
Closing Balance ( D -- C ).	600.	500.	500.	500.	500.	500

### Process Costing

Process Costing is a separate method of costing that refers to costing of operations or process involved in converting raw materials into finished goods or products. It is suitable for those types of business where continuous and mass productions of homogeneous products are being produced.

At least one question either from Normal / Abnormal Loss / Abnormal Gain or from Inter-Process-Profit or from Equivalent Production or from Joint Product / Byproduct are expected from this chapter for all examination. For solving a problem it is very important to learn various methods of valuation of work-in-progress, completed production, Abnormal Loss/ Gain etc. Abnormal Loss or Abnormal Gain should be treated as good units. Difference among Joint Product, By-product and Co-product should be clearly understood.

**Normal Loss:**

It is that kind of losses which is inherent in the processing operations. It can be expected or anticipated in advance i.e. at the time of estimation. Cost of Normal Loss is considered as part of cost of production in which it occurs. If normal loss units have any realizable scrap value, the process account is credited by the amount.

**Abnormal Loss:**

It is that loss which is caused by unexpected or abnormal conditions such as accident, machine breakdown, substandard materials etc. These losses are segregated from process costs and investigated to prevent there

occurrence in future. The Process Account is to be credited by Abnormal Loss Account with cost of materials, labor and overhead equivalent to good units and the loss due to abnormal reasons is to be transferred to Costing Profit and Loss Account.

**Abnormal Gain:**

If the actual loss of a process is less than the expected loss then the difference between the two will be treated as abnormal gain. The value of abnormal gain is transferred to the debit side of the relevant process and ultimately closed by crediting it to the Costing Profit and Loss Account.

**Application of Process Costing**

The Process costing can be used in a large variety of industries. It is very suitable for such industries where the product is manufactured through a continuous sequence of operations.

Generally, the processes costing are used in the following types of industries:

- (i) Textile and Chemical industries.
- (ii) Manufacturing Industries like iron and steel, cement, paper mill, soap-making etc.
- (iii) Mining Industries-coal, oil etc.
- (iv) Public utility services-such as gas, electricity, water supply etc.

## Topic

Module 7:  
Economics of  
Maintenance  
and Spares  
Management

# INTERMEDIATE

## Group II - Paper-9

Operations  
Management  
and Strategic  
Management  
(OMSM)

## Operations Management

In this issue we will discuss some special features on Economics of Maintenance and Spares Management

In modern industrial operations, physical assets (plant, machinery, and equipment) are the backbone of production. However, these assets degrade over time due to wear, tear, and obsolescence. Managing this degradation requires a strategic balance between Maintenance, Repair, and Operations (MRO) spares management and Asset Replacement Decisions.

From an economic standpoint, the objective is never to achieve zero breakdowns at any cost, but rather to minimize the Total Cost of Ownership (TCO).

### *Economics of Maintenance*

Basic concept: Under economics of maintenance, companies often plot two curves:

#### 1. Maintenance Costs Curve

- As you do *more* maintenance (more inspections, more part replacements, etc.), your maintenance costs go up.

#### 2. Failure Costs Curve

- If you do *less* maintenance, the machine fails more often, so failure costs (repairs + downtime) go up.
- But if you do *more* maintenance, failure costs go down because you prevent breakdowns.

When we add these two curves together, you get the Total Cost Curve.

Here's what the curves would look like:

- At first, doing a little maintenance saves you a lot in failures.
- But after a point, doing *too much* maintenance costs more than it saves.
- The lowest point on the Total Cost Curve is the optimal maintenance level — that's the sweet spot you want.

### **Summary:**

The goal is not to minimize maintenance costs or failure costs individually, but to minimize the total costs.

Let's build a simple example together:

Suppose we have this situation:

Maintenance Effect (%)	Maintenance Cost (R/year)	Failure Cost (R/year)	Total Cost (R/year)
0	0	20000	20000
20	2000	12000	14000
40	4500	7000	11500
60	7500	5000	12500
80	11000	4000	15000
100	15000	3800	18800

Look at the **Total Cost** column:

- At 0% maintenance: R20000/year
- At 20% maintenance: R14000/year
- At 40% maintenance: R11500/year (lowest!) ← optimal point
- At 60%, 80%, and 100% maintenance: Total cost starts rising again.

### **Conclusion:**

The optimal maintenance effort here is around 40% — it gives you the lowest total cost.

Doing less maintenance causes more expensive failures.

Doing more maintenance costs more without enough extra savings.

Therefore economics of maintenance revolves around a classic optimization problem: balancing the cost of performing maintenance against the cost of neglecting it.

Total Maintenance Cost = Cost of Corrective Maintenance + Cost of Preventive Maintenance

### **The Cost Trade-Off Model**

**Preventive Maintenance (PM) Cost:** This includes scheduled inspections, lubrication, parts replacement, and labor. As the frequency of PM increases, these costs rise linearly or exponentially.

**Corrective Maintenance (CM) / Breakdown Cost:** This includes emergency repair labor, premium freight for urgent spares, lost production capacity, idle labor, and potential safety/environmental penalties. As PM increases, breakdown costs drop drastically.

The economic objective is to operate at the Optimal Maintenance Level, where the summation of both costs (Total Cost) is minimized.

### **Economic Evaluation of Maintenance Strategies:**

1. Breakdown (Run-to-Failure) Strategy: Economically viable only for non-critical, low-cost assets where the cost of a PM cycle exceeds the cost of failure and replacement.

- Time-Based/Scheduled Maintenance: PM is performed at fixed intervals (e.g., every 3 months). Economically efficient if the asset follows a predictable wear-out pattern. If applied to assets with random failure modes, it introduces the economic waste of “over-maintenance.”
- Condition-Based Maintenance (CBM) / Predictive Maintenance: Maintenance is triggered by asset condition indicators (e.g., vibration analysis, thermography, oil analysis). While the initial capital investment in sensors and diagnostic software is high, it offers the highest economic return for critical assets by eliminating premature part replacements and preventing catastrophic failures.

### Spares Management Economics

Spares management is uniquely challenging because it sits at the intersection of maintenance readiness and inventory capital lock-up. Holding too many spares ties up working capital; holding too few leads to expensive downtime.

### Inventory Costs Categories

- Holding (Carrying) Costs:** Includes capital costs (interest on funds blocked), storage space costs, insurance, obsolescence, and deterioration. This typically ranges from 15% to 30% of the inventory value annually.
- Ordering / Procurement Costs:** Costs associated with raising a purchase order, inspection, and logistics.
- Stock out Costs:** The economic penalty when a critical spare is unavailable during a breakdown (unabsorbed overheads, lost sales revenue).

### Illustration 1:

Annual Demand 2000 units (Constant). Purchase price p.u. R10 p.u. Holding Cost R2.40 p.u. Ordering cost R150 per order. Compute EOQ by graphical method as well as by formula.

**Answer:**

Order Q	Average	No of orders	Ordering cost	Holding Cost	Total
100	50	20	3000	120	3120
200	100	10	1500	240	1740
300	150	6.666666667	1000	360	1360
400	200	5	750	480	1230
500	250	4	600	600	1200
600	300	3.333333333	500	720	1220
700	350	2.857142857	428.5714286	840	1268.571
800	400	2.5	375	960	1335
900	450	2.222222222	333.3333333	1080	1413.333
1000	500	2	300	1200	1500
1200	600	1.666666667	250	1440	1690
1400	700	1.428571429	214.2857143	1680	1894.286
1600	800	1.25	187.5	1920	2107.5
1800	900	1.111111111	166.6666667	2160	2326.667
2000	1000	1	150	2400	2550

$$EOQ = \sqrt{(2 D O)/h} = \sqrt{(2 \times 2000 \times 150)/2.40} = 500$$

### Selective Inventory Control Models

To optimize these costs, organizations categorize spares using different frameworks:

Framework	Basis of Classification	Economic Application
ABC Analysis	Annual Consumption Value (Capital usage)	A items (High value) get strict control and low safety stock. C items (Low value) are bought in bulk
VED Analysis	Criticality to Production (Vital, Essential, Desirable)	Vital items require guaranteed availability (high safety stock), regardless of cost, to avoid catastrophic stockout penalties.
SDE Analysis	Procurement Lead Time (Scarce, Difficult, Easy)	Scarce/Difficult items require long-term contracts or higher buffer stocks to mitigate market supply risks.

### Economic Order Quantity (EOQ) for Spares

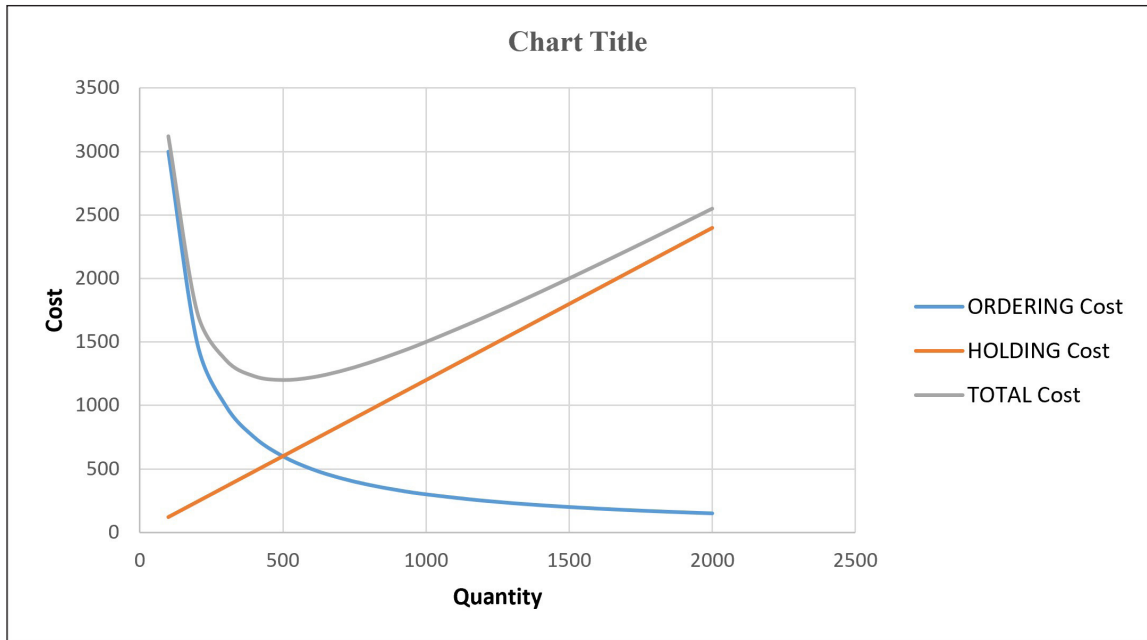
For non-repairable, regularly consumed maintenance items (like seals, gaskets, or filters), the standard EOQ model balances ordering and holding costs:

$$EOQ = \sqrt{(2 D O)/h}$$

Where:

D = Annual demand quantity, S = Ordering cost, H = Holding cost per unit

EOQ is the ordering quantity at which total cost comprising Ordering cost and holding cost is at its minimum. More order quantities push up the holding cost but pull down the ordering cost. EOQ occurs at the point of trade-off between these two costs as depicted in the following fig:



**Illustration 2:** In previous illustration, say total working days in the year is 250 days and lead time (time from the date placing the order to date of receipt of order) is 15 days (Constant), then what will be reorder point?

**Answer:**

No of working days =250			
lead time =15 days			
So with an annual demand of 2000, per day demand = 2000/250 =			8
So demand for 15 days = 15*8 =		120	
So when stock level is at 120, place for reorder.			

**Illustration 3:** Refer illustration 1. Compute optimum interval between two consecutive orders.

**Answer:**

optimum interval between two consecutive orders			
EOQ/D			
2000 can complete 1 year			
so 500 can complete 500/2000 = 0.25 years			

**Illustration 4:** Refer illustration 1. Compute Annual total variable inventory cost.

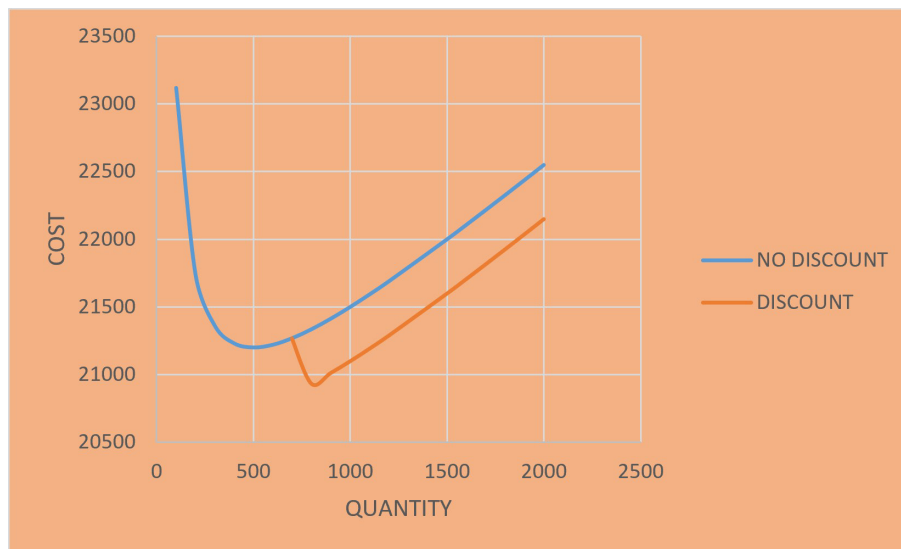
**Answer:**

Annual total variable inventory cost =		TC = Q/2*h+D/Q*O	
or TC = SQRT(2DOh)	or SQRT(2DOic)	SQRT(2x2000x150 x 2.4)	1200

**Illustration 5.** EOQ with price break (Single)--Refer 1st Illustration. Suppose the supplier informs that if the order size is at least 800 units then a discounted price of R9.80 per unit will be offered. Do you accept the offer?

**Answer:**

EOQ with price break(Single)			
in the previous problem Cost p.u is Rs.9.80 provided 800 units are purchased at a time			
at 500: Total annual cost= $500/2 \times 2.4 + 2000/500 \times 150 + 2000 \times 10 =$			21200
at 800: Total annual cost= $800/2 \times 2.4 + 2000/800 \times 150 + 2000 \times 9.8 =$			20935
Go for 800			



Since the cost at minimum order quantity 800 and above is lower than the cost at EOQ of 500 units, we must give order at 800 units. The above shown curve shows a sizeable drop in the cost due to the price discount at a quantity of 800 units. At this level the total cost is lower than the total cost corresponding to 500 units.

### Insurance Spares Economics

Insurance spares are high-value, critical components (e.g., a massive power transformer or a custom turbine shaft) with a very low probability of failure but catastrophic stockout consequences. Their procurement is evaluated using risk-monetization matrices:

$$\text{Expected Annual Risk Cost} = \text{Probability of Failure} \times \text{Cost of Total Downtime}$$

If the Expected Annual Risk Cost over the equipment life exceeds the annualized capitalized cost of the spare, buying the insurance spare is economically justified.

**Illustration 1: A manufacturing plant has a critical machine. Historical data shows that there is a 10% probability that a key spare part will fail during a year.**

If the spare part fails and no replacement is immediately available, the plant will remain shut down for several days, causing a total downtime cost of R1,500,000.

Calculate the Expected Annual Risk Cost of not stocking the spare part.

**Answer:**

$$\text{Expected Annual Risk Cost} = \text{Probability of Failure} \times \text{Cost of Total Downtime} = 0.1 \times 1500000 = 150000$$

The firm is effectively exposed to an average annual risk cost of R1.5 lakh by not stocking the spare part. If the annual cost of carrying the spare in inventory (capital cost, storage cost, insurance, etc.) is less than R1.5 lakh, it may be economically justified to keep the spare in stock. If the carrying cost is significantly more than R1.5 lakh, management may decide not to stock it.

**Illustration 2:** A power plant operates a critical turbine. Failure of a particular rotor assembly can lead to complete shutdown of the plant until a replacement is procured.

The following information is available:

Item	Value
Probability of motor failure in a year	6%
Average downtime if failure occurs	15 days
Loss of contribution margin per day of shutdown	R100000
Penalty payable to customers per day of shutdown	R20000
Repair team and emergency logistics cost (One time)	R300000

Calculate the Expected Annual Risk Cost of not stocking the rotor assembly.

**Answer:**

Step 1: Calculate Total Downtime Cost if Failure Occurs

(a) Loss of contribution margin:

$$\begin{aligned} & \text{Average downtime if failure occurs} * \text{Loss of} \\ & \text{contribution margin per day of shutdown} \\ & = 15 * 100000 \\ & = 1500000 \end{aligned}$$

(b) Customer penalties:

$$\begin{aligned} & \text{Average downtime if failure occurs} * \text{Penalty payable} \\ & \text{to customers per day of shutdown} \\ & = 15 * 20000 = 300000 \end{aligned}$$

(c) Repair team and emergency logistics cost (One time)

$$\begin{aligned} \text{Total downtime cost} & = 1500000 + 300000 + 300000 \\ & = 2100000 \end{aligned}$$

Step 2: Calculate Total Downtime Cost if Failure Occurs

Expected Annual Risk Cost = Probability of Failure \* Cost of Total Downtime

$$= 0.06 * 2100000$$

$$= 126000$$

### ***Economics of Machine Replacement***

Machinery replacement decisions represent major capital expenditure (CAPEX) considerations. Assets must be replaced due to two primary economic forces: Physical Degradation (rising operating and maintenance costs) and Obsolescence (availability of newer, highly efficient alternatives).

### **Economic Life of an Asset (The Minimum Cost Criterion)**

The economic life of a machine is the period over which its Average Annual Total Cost is minimized.

As a machine ages:

- Its Capital Cost Component (Depreciation/Capital Loss) decreases because the initial purchase cost is spread over more years, and its salvage value drops at a decreasing rate.
- Its Operating & Maintenance (O&M) Costs increase due to wear, loss of efficiency, and higher frequency of breakdowns.

The point where the combined average annual cost curve hits its lowest point dictates the Economic Life of the asset, indicating the optimal time for replacement.

### ***Suggestions:***

*This lesson is prepared purely from teachings imparted by the Guide book issued by Institute. The study guide on Operations Management issued by Institute is to be studied thoroughly. For supplementary readings one can refer Operations Management by R.S. Russell & B.W. Taylor, Operations Management by J Stevenson.*

*Best Wishes.*

## Topic

Module 5:  
Accounting  
Standards

Module 8:  
Auditing of  
Different Types of  
Undertakings

INTERMEDIATE

Group II - Paper-10

Corporate  
Accounting and  
Auditing (CAA)

## Section A: Corporate Accounting

### Topic: Accounting Standards

#### • Multiple Choice Questions

1. The primary objective of Ind AS 1 is to:
- Prescribe accounting treatment for inventories
  - Prescribe principles for presentation of general-purpose financial statements
  - Prescribe accounting for employee benefits
  - Prescribe accounting for income taxes

**Answer:** B, Prescribe principles for presentation of general-purpose financial statements

2. Ind AS 1 applies to:
- Only consolidated financial statements
  - Only separate financial statements
  - Both consolidated and separate financial statements prepared under Ind AS
  - Management accounting reports

**Answer:** C, Both consolidated and separate financial statements prepared under Ind AS

3. Which of the following is NOT a component of a complete set of financial statements under Ind AS 1?
- Statement of Financial Position (Balance Sheet)
  - Statement of Cash Flows
  - Directors' Report
  - Statement of Changes in Equity

**Answer:** C, Directors' Report

4. An entity shall present a complete set of financial statements:
- Monthly
  - Quarterly
  - Half-yearly
  - At least annually

**Answer:** D, At least annually

5. Financial statements prepared in accordance with Ind AS shall present:
- Historical cost only
  - Fair value only
  - True and fair view of financial position and performance
  - Taxable income only

**Answer:** C, True and fair view of financial position and performance

6. Under Ind AS 1, financial statements are generally prepared using:
- Cash basis accounting
  - Accrual basis accounting
  - Hybrid accounting
  - Realisation basis accounting

**Answer:** B, Accrual basis accounting

7. Which of the following is a fundamental assumption emphasized by Ind AS 1?
- Prudence only
  - Historical Cost
  - Going Concern
  - Conservatism

**Answer:** C, Going Concern

8. Under Ind AS 1, assets and liabilities should generally:
- Be offset against each other
  - Be presented net of provisions
  - Not be offset unless required or permitted by an Ind AS
  - Always be offset when material

**Answer:** C, Not be offset unless required or permitted by an Ind AS

9. Comparative information for the preceding period is:
- Optional
  - Mandatory unless specifically exempted by an Ind AS
  - Required only for listed companies
  - Required only for balance sheet items

**Answer:** B, Mandatory unless specifically exempted by an Ind AS

10. When an entity retrospectively applies an accounting policy, it is generally required to present:
- One Balance Sheet
  - Two Balance Sheets
  - Three Balance Sheets
  - Four Balance Sheets

**Answer:** C, Three Balance Sheets

11. Material items under Ind AS 1:

- A. May be aggregated with unrelated items
- B. Need not be disclosed separately
- C. Shall be presented separately in the financial statements
- D. Are disclosed only in notes

**Answer:** C, Shall be presented separately in the financial statements

12. An entity may change the presentation and classification of items in financial statements:

- A. Every year
- B. Only when management changes
- C. When required by an Ind AS or when it results in more appropriate presentation
- D. At the auditor's discretion

**Answer:** C, When required by an Ind AS or when it results in more appropriate presentation

13. If financial statements are not prepared on a going concern basis, the entity should disclose:

- A. Only the fact of non-compliance
- B. The fact, the basis used, and the reasons for not using going concern assumption
- C. Only the reasons
- D. No disclosure is required

**Answer:** B, The fact, the basis used, and the reasons for not using going concern assumption

14. Which of the following may be provided voluntarily in addition to the financial statements under Ind AS 1?

- A. Environmental Report
- B. Value Added Statement
- C. Human Resource Statement
- D. All of the above

**Answer:** D, All of the above

15. An entity whose financial statements comply with Ind AS shall:

- A. Mention compliance only in the auditor's report
- B. Make an explicit and unreserved statement of compliance in the notes

C. Mention compliance only in the Board's Report

D. Not disclose compliance separately

**Answer:** B, Make an explicit and unreserved statement of compliance in the notes

• **Comprehensive Problems**

1. X Limited earned a net profit of ₹78,00,000 and ₹1,18,80,000 for the years 2024-25 & 2025-26, respectively.

The following information was given for 2025-2026:

- (i) The company declared rights issue of two new shares for each five outstanding shares.
- (ii) 8,00,000 shares were outstanding prior to rights issue.
- (iii) Rights issue price was ₹27.50 and the last date to exercise rights was 1st July, 2025.
- (iv) Fair value of one equity share immediately prior to exercise of rights on 1st July, 2025 was ₹143.

You are required to compute Basic Earnings Per Share as per Ind AS 33:

- (i) For the year 2024-25, and
- (ii) For the year 2025-26

**Solution:**

Basic EPS for 2024-25 =  $78,00,000/8,00,000 = ₹9.75$

Basic EPS for 2024-25 restated for rights issue =  $78,00,000 / (8,00,000 \times 1.3) = ₹7.50$

Basic EPS for 2025-26 =  $1,18,80,000 / (800000 \times 1.3 \times 3/12 + 11,20,000 \times 9/12) = ₹10.80$

**Working Note:**

1. No. of rights shares issued =  $8,00,000 \times 2/5 = 3,20,000$
2. Theoretical Ex-right fair value = (Aggregate Market value of share immediately prior to the exercise of the rights + Proceeds from exercise of the rights)/Number of shares outstanding immediately after the right issue  
 $= (8,00,000 \times 143 + 3,20,000 \times 27.50)/(800000 + 320000) = ₹110.00$
3. Right factor = Fair value per share immediately prior to right issue/Theoretical ex-right fair value per share =  $143/110 = 1.3$

## Section B: Auditing

**Question: Suggest the audit procedure for the audit of an amusement park.**

**Answer:**

### **Audit Procedure for an Amusement Park**

An amusement park generates revenue from ticket sales, rides, food courts, parking facilities, advertisements, and merchandise sales. The auditor should pay special attention to revenue collection, cash handling, safety compliance, and maintenance of rides.

#### **1. Examination of Internal Control System**

The auditor should study the internal control system relating to ticket issuance, cash collection, entry control, inventory management, and authorization procedures. Particular attention should be paid to segregation of duties between ticket issuance, cash collection, and accounting functions.

#### **2. Verification of Ticket and Admission Revenue**

The auditor should examine ticket books, electronic ticketing records, online booking reports, and gate-entry records. Revenue recorded should be reconciled with the number of visitors admitted. Complimentary passes, discounted tickets, and cancelled tickets should be verified with proper authorization.

#### **3. Verification of Cash Receipts**

Since a large portion of revenue may be collected in cash, the auditor should review daily cash summaries, verify timely deposit of collections into bank accounts, and compare cash receipts with ticket sales reports. Surprise cash verification may also be conducted.

#### **4. Audit of Ride and Attraction Income**

Revenue earned from special rides, games, water parks, and premium attractions should be checked with supporting records and computerized reports. The auditor should ensure that all collections are properly accounted for.

#### **5. Verification of Food Court and Merchandise Sales**

Sales from restaurants, food stalls, gift shops, and souvenir counters should be verified with Point-of-Sale (POS) reports and inventory records. Gross profit ratios may be compared with previous years to identify unusual variations.

#### **6. Verification of Fixed Assets**

The auditor should verify ownership and existence of rides, machinery, buildings, equipment, and other fixed assets. Additions and disposals during the year should be checked with supporting documents. Depreciation should be verified according to the applicable accounting policies.

#### **7. Review of Maintenance and Repair Expenses**

Amusement rides require regular maintenance. The auditor should examine maintenance contracts, service records, and repair bills. Major expenditures should be reviewed to determine whether they should be capitalized or charged as revenue expenses.

#### **8. Verification of Inventory**

Physical verification reports relating to food items, merchandise, spare parts, and consumables should be examined. The auditor should ensure that inventory is properly valued and accounted for.

#### **9. Audit of Payroll**

The auditor should verify attendance records, wage sheets, salary registers, and statutory deductions. Special attention should be given to payments made to temporary and seasonal employees.

#### **10. Verification of Safety and Regulatory Compliance**

The auditor should examine safety inspection certificates, operating licences, insurance policies, and compliance with local regulatory requirements. Any penalties, notices, or violations should be reviewed.

#### **11. Verification of Insurance and Claims**

The auditor should verify insurance coverage for rides, buildings, employees, and visitors. Accident claims, compensation payments, and pending litigation should be examined to determine whether adequate provisions have been made.

#### **12. Analytical Review**

The auditor should compare visitor attendance, ticket revenue, operating expenses, and profitability with previous years and budgeted figures. Significant fluctuations should be investigated and explained.

## Topic

Module 6:  
Working Capital  
Management

Module 8:  
Introduction to  
Data Science  
for Business  
Decision-making

# INTERMEDIATE

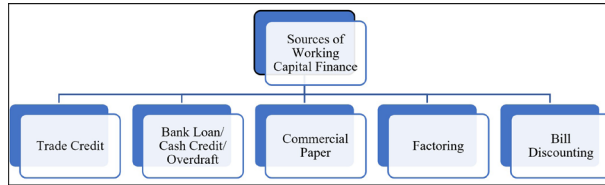
## Group II - Paper-11

Financial  
Management and  
Business Data  
Analytics (FMDA)

## Financial Management

### Working Capital Financing

#### Working Capital Financing



Working capital financing refers to funds used to meet a firm's short-term operational needs, such as purchasing inventory, paying wages, and covering day-to-day expenses.

#### A. Trade Credit

Trade credit is the credit extended by a seller to a purchaser for a specified period without requiring immediate payment. It is a short-term source of working capital finance.

- (i) **Open Account Credit:** Goods are supplied, and payment is made later according to agreed terms.
- (ii) **Bills Payable/Bills of Exchange:** The buyer formally accepts a bill promising payment on a future date.

#### B. Bank Overdraft

A Bank Overdraft is a facility provided by a bank that allows an account holder to withdraw more money than the balance available in their current account, up to a specified limit. Interest is charged only on the amount actually overdrawn. It may be secured by assets such as inventory, receivables, or fixed deposits.

#### C. Short-Term Bank Loans

A short-term bank loan is a borrowing arrangement under which a bank lends money to a business for a short period, usually up to one year, to finance its working capital requirements. It may be secured or unsecured.

Uses:

- (i) Purchase of raw materials.
- (ii) Financing inventory.
- (iii) Payment of wages and salaries.
- (iv) Meeting seasonal demand.
- (v) Covering temporary cash shortages.

#### D. Cash Credit

**Cash Credit (CC)** is a short-term financing facility provided by banks that allows businesses to borrow money up to a sanctioned limit against the security of assets such as inventory, raw materials, or accounts receivable.

- (i) Granted against collateral such as stock and receivables.
- (ii) The borrower can withdraw funds as needed within the sanctioned limit.
- (iii) Interest is charged only on the amount actually utilized.
- (iv) The facility is usually renewed annually.

#### E. Commercial Paper

Commercial Paper is an unsecured promissory note issued by a company at a discount and redeemed at its face value on maturity, generally for a period ranging from a few days up to one year.

- (i) It is an **unsecured instrument** (no collateral is required).
- (ii) Issued only by companies with strong creditworthiness.
- (iii) Has a fixed maturity period, generally between **7 days and 1 year**.
- (iv) Issued at a discount and redeemed at face value.
- (v) Tradable in the money market.

#### F. Factoring

Factoring is a financial arrangement whereby a business sells its receivables to a factor at a discount to obtain immediate funds and, in many cases, collection services.

- (i) **Recourse Factoring:** The client bears the risk of bad debts. If debtors fail to pay, the factor can recover the amount from the client.
- (ii) **Non-Recourse Factoring:** The factor bears the risk of bad debts. The client is protected against debtor default.
- (iii) **Maturity Factoring:** Payment is made on the due date of receivables rather than immediately.
- (iv) **Invoice Factoring:** Financing is provided against specific invoices

#### G. Bills Discounting

Bill Discounting is the process by which a bank purchases a bill of exchange before its due date and pays the holder the bill amount after deducting discount charges (interest).

- (i) Provides immediate liquidity.
- (ii) Based on a bill of exchange.
- (iii) Short-term source of finance.
- (iv) Interest (discount) is deducted in advance.
- (v) Generally used to finance trade receivables.

### Maximum Permissible Bank Finance (MPBF)

The **Tandon Committee (1975)** recommended norms for financing working capital by banks. It suggested that borrowers should contribute a minimum portion of working capital from their own long-term funds, and banks should finance only the remaining requirement.

**MPBF:** Maximum amount of working capital finance that a bank can provide.

#### First Method of Lending

In this method, the borrower will contribute 25% of the Working Capital Gap (WCG) from long-term sources; the remaining 75% can be financed from bank borrowings. This method will give a minimum current ratio of 1:1.

$$\text{MPBF} = \text{WCG} - 25\% \text{ of WCG}$$

Or

$$\text{MPBF} = 75\% \times (\text{CA} - \text{CL})$$

- **Current Assets (CA):** Cash, inventory, debtors, etc.
- **Current Liabilities (CL):** Creditors and other liabilities excluding bank borrowings.
- **Working Capital Gap (WCG):** Current Assets – Current Liabilities

#### Second Method of Lending

In the second method, the borrower will contribute 25% of the total current assets. The remaining of the working capital gap (i.e., the working capital gap less the borrower's contribution) can be bridged from the bank borrowings. This method will give a current ratio of 1.3:1.

$$\text{MPBF} = \text{CA} - \text{CL} - 25\% \text{ CA}$$

or

$$\text{MPBF} = 75\% \text{ CA} - \text{CL}$$

#### Third Method of Lending

The Third Method of Lending was recommended by the Tandon Committee for determining the Maximum Permissible Bank Finance (MPBF). It is more stringent than the First and Second Methods.

- The borrower must finance **100% of Core Current Assets** from long-term funds.
- The borrower must also finance **25% of the remaining Current Assets** (i.e., Current Assets excluding Core Current Assets) from long-term sources.
- The bank finances the balance amount.

$$\text{MPBF} = \text{CA} - \text{CL} - \text{Core CA} - 25\% (\text{CA} - \text{Core CA})$$

### Example 1 (First Method of Lending)

Given:

- Current Assets (CA) = ₹1,200 lakh
- Current Liabilities (CL) (excluding bank borrowings) = ₹300 lakh

Calculate MPBF under the First Method.

**Answer:**

$$\begin{aligned} \text{Working Capital Gap (WCG)} &= \text{CA} - \text{CL} \\ &= ₹1200 \text{ lakh} - ₹300 \text{ lakh} \\ &= ₹900 \text{ lakh} \end{aligned}$$

Borrower's Contribution (25% of WCG)

$$\begin{aligned} &= 25\% \times ₹900 \text{ Lakh} \\ &= ₹225 \text{ lakh} \end{aligned}$$

$$\begin{aligned} \text{MPBF} &= \text{WCG} - \text{Borrower's Contribution} \\ &= ₹900 \text{ Lakh} - ₹225 \text{ Lakh} \\ &= ₹675 \text{ lakh} \end{aligned}$$

Maximum Permissible Bank Finance = ₹675 lakh

### Example 2 (Second Method of Lending)

Given:

- Current Assets = ₹1,500 lakh
- Current Liabilities = ₹400 lakh

Calculate MPBF under the Second Method.

**Answer:**

$$\begin{aligned} \text{Borrower's Contribution} &= 25\% \times \text{Current} \\ &= 25\% \times ₹1,500 \text{ Lakh} \\ &= ₹375 \text{ lakh} \end{aligned}$$

$$\begin{aligned} \text{MPBF} &= \text{CA} - \text{CL} - 25\% \text{ CA} \\ &= ₹1,500 \text{ Lakh} - ₹400 \text{ Lakh} - ₹375 \\ &= ₹725 \text{ lakh} \end{aligned}$$

Maximum Permissible Bank Finance = ₹725 lakh

### Example 3

Given:

Particulars	₹ lakh
Raw Materials	200
Work-in-Progress	150
Finished Goods	250
Debtors	300
Cash	100
Creditors	250
Outstanding Expenses	50

Calculate MPBF under the Second Method.

**Answer:**

**Current Assets:**

$$\begin{aligned} \text{CA} &= ₹200\text{L} + ₹150\text{L} + ₹250\text{L} + ₹300\text{L} + ₹100\text{L} \\ &= ₹1,000 \text{ lakh} \end{aligned}$$

**Current Liabilities**

$$\text{CL} = ₹250\text{L} + ₹50\text{L} = ₹300 \text{ lakh}$$

$$\begin{aligned} \text{MPBF} &= \text{CA} - \text{CL} - 25\% \text{ CA} \\ &= ₹1,000\text{L} - ₹300\text{L} - ₹250\text{L} = ₹450 \text{ lakh} \end{aligned}$$

Maximum Permissible Bank Finance = ₹450 lakh

**Example 4 (Third Method)**

Given:

- Current Assets = ₹2,000 lakh

- Current Liabilities = ₹500 lakh

- Core Current Assets = ₹300 lakh

Calculate MPBF under the Third Method.

**Answer:**

$$\text{MPBF} = \text{CA} - \text{CL} - \text{Core CA} - 25\% (\text{CA} - \text{Core CA})$$

Current Assets excluding Core Assets:

$$= ₹2,000\text{L} - ₹300\text{L} = ₹1,700 \text{ lakh}$$

Borrower's contribution: Core CA + 25% (1,700)

$$= ₹300\text{L} + ₹425\text{L} = ₹725 \text{ lakh}$$

MPBF:

$$= ₹2,000\text{L} - ₹500\text{L} - ₹725\text{L} = ₹775 \text{ lakh}$$

Maximum Permissible Bank Finance = ₹775 lakh

## DATA ANALYTICS (DATA PROCESSING AND DATA SCIENCE)

### Data Science and its uses in Finance

Data science is an interdisciplinary field that uses scientific methods, algorithms, and systems to extract knowledge and insights from structured and unstructured data. It combines mathematics, statistics, computer science, and business expertise to turn raw information into actionable strategies.

Data Science is widely used in finance to analyze large amounts of financial data, identify patterns, predict future trends, and support decision-making. The major uses of Data Science in Finance are:

**1. Risk Management:** Data Science helps financial institutions identify, measure, and manage risks such as: Credit Risk, Market Risk, Liquidity Risk and Operational Risk. Example: predicting the probability of loan default by a borrower.

**2. Fraud Detection and Prevention:** Machine learning algorithms can detect unusual transaction patterns and identify fraudulent activities in real time. Example: Detecting unauthorized credit card transactions.

**3. Credit Scoring:** Banks use data science techniques to assess the creditworthiness of customers before granting loans. Following are the factors are considered:

- Income
- Repayment history
- Spending patterns
- Employment status

**4. Investment and Portfolio Management:** Data Science helps investors in select securities, optimize portfolios, predict market movements and Improve returns. **Example:** Robo-advisors automatically recommend investment portfolios based on customer preferences.

**5. Algorithmic Trading:** Financial institutions use automated trading systems that analyze market data, identify opportunities and execute trades instantly. This

increases trading efficiency and reduces human errors.

**6. Stock Price Forecasting:** Using historical market data and machine learning models, analysts can forecast: Stock prices, Market trends, Interest rates and Exchange rates

**7. Customer Analytics:** Financial institutions analyze customer behavior to: Understand customer needs, improve services and Increase customer retention. **Example:** Personalized loan or investment product recommendations.

**8. Budgeting and Financial Planning:** Data Science assists organizations in: Revenue forecasting, Expense forecasting, Cash flow analysis and Financial planning.

**9. Regulatory Compliance:** Financial firms use analytics to ensure compliance with regulations issued by authorities such as: Reserve Bank of India and Securities and Exchange Board of India

**10. Sentiment Analysis:** Data Science analyzes: News articles, Social media posts, Financial reports, to determine investor sentiment and predict market reactions.

**11. Customer Segmentation:** Banks classify customers into different groups based on: Income, Age, Investment preferences, Spending behavior. This enables targeted marketing strategies.

**12. Performance Measurement:** Organizations use data analytics to evaluate: Profitability, Return on Investment (ROI), Residual Income (RI), Economic Value Added (EVA) and Balanced Scorecard metrics

**13. Insurance Analytics:** Insurance companies use data science for: Premium pricing, Claim prediction, Fraud detection and Risk assessment

**14. Cash Flow Forecasting:** Businesses can predict future cash inflows and outflows, helping maintain liquidity and avoid financial distress.

## Topic

Module 5:  
Transfer Pricing

Module 8:  
Divisional  
Performance  
Measurement

# INTERMEDIATE

## Group II - Paper-12

### Management Accounting (MA)

## Transfer Pricing

### Introduction

Transfer Pricing refers to the price charged by one division, department, profit centre, or subsidiary of an organization to another for goods or services transferred internally. In a decentralized business organization, different divisions operate as separate responsibility centres and are often evaluated based on their profitability. Consequently, the transfer price becomes revenue for the supplying division and cost for the receiving division. The method adopted for fixing transfer prices therefore has a direct impact on divisional profits, managerial performance evaluation, motivation, and decision-making. Transfer pricing is not merely an accounting exercise; it is an important management control mechanism that supports planning, coordination, and performance measurement. It is also a significant issue in multinational corporations because transfer prices influence the allocation of profits among different countries and affect taxation.

### Need for Transfer Pricing

The growth of large organizations has led to the adoption of divisional structures in which managers are entrusted with considerable autonomy. In such organizations, products and services frequently move from one division to another before reaching the final customer. Transfer pricing becomes necessary to assign value to these internal transactions and to assess the performance of individual divisions. Without an effective transfer pricing system, it would be difficult to determine whether a division is operating efficiently and contributing positively to overall organizational objectives. Transfer pricing also helps management compare internal transactions with external market alternatives and promotes accountability among divisional managers.

### Advantages of Transfer Pricing

A well-designed transfer pricing system offers several benefits to an organization. It facilitates decentralization by allowing divisional managers to make independent decisions while remaining accountable for performance. It reduces the burden on top management by distributing decision-making responsibilities throughout the organization. Transfer pricing also improves managerial motivation because managers have greater control over activities that affect their reported performance. Additionally, it encourages cost consciousness and efficiency by enabling divisions to compare internal transfer prices with external market prices.

The major advantage of transfer pricing is it:

- Facilitate decentralization and delegation of authority.
- Improves managerial motivation and accountability.

- Provides a basis for divisional performance evaluation.
- Assists in planning and control.
- Encourages efficient utilization of resources.
- Develops managerial competence and leadership skills.
- Enables comparison between internal and external sourcing options.

### Objectives of Transfer Pricing

An effective transfer pricing system should satisfy several objectives simultaneously. The primary objective is to measure divisional profitability accurately so that managerial performance can be evaluated fairly. Another important objective is to promote goal congruence, whereby divisional managers acting in their own interests also contribute to the achievement of organizational goals. The system should preserve divisional autonomy and encourage managers to make decisions that maximize both divisional and corporate profitability. Furthermore, transfer pricing should support efficient resource allocation and ensure that internal transactions are conducted in a manner beneficial to the organization. In multinational enterprises, transfer pricing also helps prevent manipulation of profits solely for tax reduction purposes.

The essential objectives are:

- Accurate measurement of divisional performance.
- Promotion of goal congruence.
- Motivation of divisional managers.
- Preservation of divisional autonomy.
- Optimum utilization of organizational resources.
- Fair allocation of profits among divisions.

### Characteristics of a Good Transfer Pricing System

A good transfer pricing system should encourage managers to make decisions that are in the best interests of the organization. It should provide reliable information for decision-making, motivate managers to maintain a high level of effort, and preserve the autonomy of divisions. At the same time, the system should facilitate fair performance evaluation and ensure that resources are allocated optimally. A transfer pricing method that satisfies these conditions is more likely to achieve both divisional and organizational objectives.

### Methods of Transfer Pricing

Transfer pricing methods are broadly classified into:

1. Cost-Based Transfer Pricing
2. Market-Based Transfer Pricing
3. Negotiated Transfer Pricing

## Cost-Based Transfer Pricing

Cost-based transfer pricing is used when an external market price is unavailable or difficult to determine. Under this approach, transfer prices are established based on production costs incurred by the supplying division. The CMA study material identifies four major cost-based approaches: marginal cost, absorption cost, standard cost, and two-part tariff.

### *Marginal Cost Method*

Under the marginal cost method, transfer price is fixed at the variable cost of production. This method is particularly useful when the supply division has excess capacity because there is little or no opportunity cost associated with internal transfers. It promotes sound short-term decision-making and ensures efficient utilization of idle resources. However, since the supply division receives no contribution towards fixed costs, its profitability may appear poor, reducing managerial motivation.

### *Absorption Cost Method*

Under this method, both variable and fixed manufacturing costs are included in the transfer price. The supply division therefore recovers a share of fixed costs and reports improved profitability. While this method appears fair to the selling division, it may encourage the buying division to purchase externally if the transfer price exceeds the market price. Consequently, decisions beneficial to individual divisions may prove harmful to the organization.

### *Standard Cost Method*

The standard cost method uses predetermined standard costs rather than actual costs as the basis for transfer pricing. This prevents inefficiencies of the supplying division from being transferred to the receiving division. Variances remain the responsibility of the supply division, thereby promoting cost control and efficiency. Many organizations consider this method more equitable than actual-cost-based transfer pricing.

### *Two-Part Tariff Method*

Under the two-part tariff system, products are transferred at marginal cost while a separate fixed charge is levied on the receiving division. The fixed fee is intended to recover fixed costs and provide an adequate return on investment. This method combines the decision-making benefits of marginal costing with the profitability requirements of the supplying division, although it may be administratively complex.

### *Advantages of Cost-Based Transfer Pricing*

- Cost information is readily available.
- Suitable when no external market exists.
- Facilitates internal transfers.

- Consistent with cost-centre performance evaluation.

### *Limitations of Cost-Based Transfer Pricing*

- Actual costs may transfer inefficiencies.
- May distort divisional performance.
- Can lead to sub-optimal decisions.
- May not encourage cost reduction efforts.

## Market-Based Transfer Pricing

Market-based transfer pricing uses the prevailing market price of a comparable product or service as the transfer price. This method is considered the most objective because it reflects the economic value of the transferred product and simulates transactions between independent entities. Divisional profits calculated under this method closely resemble those that would be earned if divisions operated as separate businesses. As a result, market-based pricing promotes divisional autonomy, realistic performance evaluation, and goal congruence.

The method is particularly suitable when a competitive external market exists, and both divisions have the freedom to buy or sell externally.

### *Advantages of Market-Based Transfer Pricing*

- Objective and easy to understand.
- Encourages efficiency and competitiveness.
- Promotes divisional autonomy.
- Facilitates realistic performance measurement.

### *Limitations of Market-Based Transfer Pricing*

- Comparable market prices may not always exist.
- Market prices may fluctuate significantly.
- Internal cost savings may not be reflected.
- Differences in discounts and credit terms may complicate pricing decisions.

## Negotiated Transfer Pricing

Negotiated transfer pricing involves mutual agreement between the buying and selling divisions. This method is generally used when market prices are unavailable and divisional autonomy is highly valued. Since managers participate directly in determining the transfer price, the outcome is usually acceptable to both parties. The method provides flexibility and preserves divisional independence.

However, negotiated pricing may result in prolonged bargaining and disputes. The final transfer price may depend more on negotiating power than on economic considerations. In cases where negotiations fail, top management may need to intervene, thereby reducing divisional autonomy.

## Divisional Performance and Goal Congruence

A transfer pricing system should motivate divisional managers to make decisions that enhance both divisional and organizational performance. However, conflicts often arise because managers tend to focus on maximizing divisional profits. An inappropriate transfer price may lead to misleading performance measures, disputes among divisions, and decisions that are beneficial to individual divisions but detrimental to the company. Therefore, transfer pricing must balance divisional autonomy with organizational objectives. Achieving goal congruence remains one of the most important challenges in transfer pricing.

### Determination of Transfer Price

Transfer prices should normally lie within a specified range. The minimum transfer price is equal to the supplying division's marginal cost plus any opportunity cost associated with the transfer. The maximum transfer price is the lowest market price at which the receiving division can obtain the product externally, adjusted for any internal cost savings. The actual transfer price generally falls between these limits and depends on negotiation, organizational policy, and prevailing market conditions.

### International Transfer Pricing

International transfer pricing refers to pricing transactions between divisions or subsidiaries located in different countries. The growth of multinational enterprises and international trade has made transfer pricing a significant issue in global business. Since tax rates differ across countries, multinational corporations often have incentives to shift profits from high-tax jurisdictions to low-tax jurisdictions through transfer pricing arrangements. Consequently, governments and tax authorities closely monitor such transactions.

The major factors influencing international transfer pricing include:

- Differences in tax rates.
- Import duties and tariffs.
- Dividend repatriation restrictions.
- Foreign exchange fluctuations.
- Political and economic conditions.
- Cash flow requirements of subsidiaries.
- Competitive position in foreign operations.

The foundation of international transfer pricing is the Arm's Length Principle, which requires that transactions between related entities be priced as if they were conducted between independent parties under similar circumstances. This principle ensures fairness, transparency, and proper allocation of taxable profits among jurisdictions. It forms

the basis of transfer pricing regulations adopted by most countries and international organizations.

### Conclusion

Transfer pricing is a fundamental component of management accounting and divisional performance evaluation. It facilitates decentralization, promotes managerial accountability, and supports organizational control. Cost-based, market-based, and negotiated transfer pricing methods each have their own advantages and limitations, and the selection of an appropriate method depends upon organizational objectives and operating conditions. An effective transfer pricing system should promote goal congruence, preserve divisional autonomy, ensure fair performance evaluation, and contribute to overall profitability. In the international context, transfer pricing assumes even greater importance because of its impact on taxation, regulatory compliance, and global profit allocation.

### Multiple Choice Questions (MCQs):

1. Transfer Pricing refers to:
  - a) Pricing goods sold to external customers only
  - b) Pricing of goods and services transferred between divisions of the same organization
  - c) Pricing of imported goods
  - d) Pricing of finished goods in the market
2. The primary objective of transfer pricing is to:
  - a) Increase sales revenue
  - b) Measure divisional performance and promote goal congruence
  - c) Minimize production cost only
  - d) Maximize market share
3. Goal congruence exists when:
  - a) Divisional managers maximize their own profits irrespective of company goals
  - b) Divisional decisions support organizational objectives
  - c) Top management takes all decisions centrally
  - d) Divisions operate independently without coordination
4. Which transfer pricing method is considered most objective when a competitive market exists?
  - a) Marginal Cost Method
  - b) Standard Cost Method
  - c) Market-Based Transfer Pricing
  - d) Negotiated Transfer Pricing

5. Under the Marginal Cost Method, transfer price is generally based on:
- Total cost of production
  - Variable cost of production
  - Market price
  - Cost plus profit
6. The standard transfer price of a component is based on variable cost of ₹100 per unit. If the supply division sacrifices a contribution of ₹20 per unit on external sales, the minimum transfer price will be:
- ₹100
  - ₹120
  - ₹80
  - ₹140
7. Which cost-based transfer pricing method prevents inefficiencies from being transferred to the receiving division?
- Marginal Cost Method
  - Actual Cost Method
  - Standard Cost Method
  - Negotiated Method
8. Under the Two-Part Tariff Method:
- Products are transferred at market price only
  - Products are transferred at marginal cost plus a fixed fee
  - Products are transferred at absorption cost only
  - Products are transferred at standard cost only
9. The maximum transfer price is generally:
- Marginal cost-plus opportunity cost
  - External purchase price adjusted for internal savings
  - Standard cost-plus profit
  - Variable cost only
10. Which of the following is a disadvantage of Negotiated Transfer Pricing?
- Encourages divisional autonomy
  - Promotes managerial participation
  - Time-consuming negotiations and conflicts
  - Flexible decision-making
11. The Arm's Length Principle requires transfer prices to be:
- Based on marginal cost only
  - Fixed by government authorities
  - Similar to prices charged between independent parties
  - Equal to standard cost
12. Which of the following factors significantly influences International Transfer Pricing?
- Weather conditions
  - Tax rates in different countries
  - Number of employees
  - Factory size

**Answer Key**

1	2	3	4	5	6	7	8	9	10	11	12
b	b	b	c	b	b	c	b	b	c	c	b

**Fill in the Blanks**

- The price charged by one division to another within the same organization is known as \_\_\_\_\_ pricing.
- The minimum transfer price is equal to marginal cost plus \_\_\_\_\_ cost.
- A transfer pricing system should promote \_\_\_\_\_ congruence between divisional and organizational objectives.
- Under market-based transfer pricing, the transfer price is based on the prevailing \_\_\_\_\_ price.
- The internationally accepted principle for transfer pricing is the \_\_\_\_\_ Length Principle.

**Answer Key**

1	2	3	4	5
Transfer	Opportunity	Goal	Market	Arm's

**State True or False**

- Transfer pricing affects the profitability of both the supply and receiving divisions.
- Market-based transfer pricing is suitable even when no comparable market price exists.
- “Standard cost” transfer pricing helps isolate inefficiencies within the supplying division.
- One objective of transfer pricing is to preserve divisional autonomy.
- The Arm's Length Principle is widely used in international transfer pricing regulations.

**Answer Key**

1	2	3	4	5
T	F	T	T	T

## Divisional Performance Measurement

### Introduction

In large business organizations, operations are often divided into separate divisions based on products, geographical regions, customer groups, or business activities. Each division functions as a distinct responsibility centre and is entrusted with a certain degree of autonomy in decision-making. As organizations grow and become complex, it becomes increasingly difficult for top management to control every activity directly. Consequently, authority is delegated to divisional managers, making performance measurement an essential aspect of management control. Divisional Performance Measurement refers to the process of evaluating the efficiency and effectiveness of different divisions and their managers in achieving organizational objectives. The primary objective is to ensure that divisional activities contribute towards maximizing shareholders' wealth and overall organizational success.

### Decentralization and Divisional Structure

Decentralization is the process of delegating decision-making authority and responsibility from top management to lower levels of management. In a decentralized organization, divisional managers are empowered to make decisions regarding operations, pricing, marketing, production, and investment within their areas of responsibility. This structure enables faster decision-making and improves responsiveness to changing market conditions. Large organizations generally adopt decentralization because top management cannot effectively manage all activities due to cognitive and operational limitations.

A decentralized organization typically establishes responsibility centres to facilitate control and accountability. These responsibility centres may be:

- Cost Centres
- Revenue Centres
- Profit Centres
- Investment Centres

Each centre is evaluated according to its specific objectives and responsibilities. Actual performance is compared with predetermined targets, thereby enabling management to identify areas requiring improvement.

### *Benefits of Decentralization*

Decentralization provides numerous benefits to an organization. Local managers possess better knowledge of local markets and operating conditions, enabling them

to make more informed decisions. Decision-making becomes faster because issues need not be referred to top management for approval. Decentralization also helps develop managerial talent, increases job satisfaction, motivates managers, and facilitates succession planning. Furthermore, it allows senior management to focus on strategic issues rather than routine operational matters.

The major benefits include:

- Development of managerial skills.
- Faster decision-making.
- Better utilization of local information.
- Reduced burden on top management.
- Improved motivation and job satisfaction.
- Enhanced managerial accountability.
- Better performance evaluation.

### *Disadvantages of Decentralization*

Despite its advantages, decentralization may create certain challenges. Divisional managers may focus on divisional objectives rather than organizational goals, leading to lack of goal congruence. Coordination between divisions may become difficult, and the organization may incur additional costs relating to training, communication, and monitoring. Poor decisions by divisional managers may also adversely affect overall organizational performance.

### Divisional Performance Measurement

Divisional performance measurement is essential in decentralized organizations because managers are granted autonomy and must be held accountable for their decisions. Performance measures enable management to evaluate whether divisions are operating efficiently and contributing to organizational objectives.

An effective performance measurement system should:

- Align divisional goals with organizational objectives.
- Encourage managerial motivation.
- Facilitate planning and control.
- Promote efficient utilization of resources.
- Support decision-making.
- Enable fair evaluation of managerial performance.

One of the important concepts in divisional performance evaluation is **Goal Congruence**. Goal congruence exists when decisions taken by divisional managers in their own

interests also contribute towards achieving the objectives of the organization as a whole. Effective performance measurement systems should promote goal congruence and discourage dysfunctional behavior.

### **DuPont Analysis**

DuPont Analysis is a comprehensive technique used to evaluate financial performance by decomposing Return on Equity (ROE) into its key components. Originally developed by the DuPont Corporation, this model helps management identify the factors responsible for changes in profitability and shareholder returns. It is widely used for divisional performance evaluation and comparative analysis among business units.

The DuPont model expresses Return on Equity as:

$$\text{ROE} = \text{Net Profit Margin} \times \text{Asset Turnover} \times \text{Financial Leverage}$$

or

$$\text{ROE} = (\text{Net Income/Sales}) \times (\text{Sales/Total Assets}) \times (\text{Total Assets/Equity})$$

The three major components of DuPont Analysis are:

1. **Net Profit Margin:** Net Profit Margin measures operating profitability and indicates the proportion of sales converted into profit. A higher profit margin reflects better cost control and pricing efficiency.
2. **Asset Turnover:** Asset Turnover measures how efficiently assets are utilized to generate sales. Higher turnover indicates effective utilization of resources and improved operational efficiency.
3. **Financial Leverage:** Financial Leverage reflects the extent to which debt is used in financing assets. While moderate leverage can improve shareholder returns, excessive leverage increases financial risk.

### **Significance of DuPont Analysis**

DuPont Analysis assists management in identifying strengths and weaknesses of different divisions. It enables managers to determine whether changes in ROE result from improved profitability, better asset utilization, or increased financial leverage. The analysis is useful for:

- Evaluating divisional performance.
- Comparing business units.
- Assessing financial health.
- Supporting investment decisions.
- Identifying areas requiring corrective action.

### **Limitations of DuPont Analysis**

Despite its usefulness, DuPont Analysis relies heavily on accounting data, which may be affected by different accounting policies and managerial manipulation. Moreover, the analysis identifies problem areas but does not explain the underlying causes of poor performance.

### **Return on Investment (ROI)**

Return on Investment (ROI) is one of the most widely used measures for evaluating divisional performance. Rather than focusing solely on profit, ROI relates profit to the assets employed in generating that profit. This provides a more meaningful measure of efficiency and profitability. ROI is particularly useful in evaluating Investment Centres and Profit Centres.

The formula for ROI is:

$$\text{ROI} = (\text{Profit Before Interest and Tax/ Capital Employed}) \times 100$$

ROI can also be expressed as:

$$\text{ROI} = \text{Profit Margin} \times \text{Asset Turnover}$$

### **Components of ROI**

1. **Profit Margin:** Profit Margin indicates the profitability generated from sales.
2. **Asset Turnover:** Asset Turnover reflects efficiency in utilizing assets to generate revenue.

Management can improve ROI by:

- Increasing profit margins.
- Improving asset turnover.
- Improving both profit margin and asset turnover simultaneously.

### **Advantages of ROI**

ROI is widely accepted because it is simple to calculate and easy to understand. It allows comparisons between divisions of different sizes and industries. It is also closely linked with accounting information available from financial statements.

The major advantages are:

- Simple and widely understood.
- Facilitates comparison among divisions.
- Considers both profit and investment.
- Useful for performance evaluation.
- Supports management control.

### **Limitations of ROI**

Although ROI is widely used, it suffers from several limitations. Managers may reject profitable investments if such investments reduce their existing ROI. This may lead to sub-optimal decision-making and conflict between divisional and organizational objectives.

Other limitations include:

- Encourages short-term orientation.
- Ignores cost of equity capital.
- Influenced by asset age and depreciation methods.
- May create lack of goal congruence.
- Can discourage beneficial investments.

### **Residual Income**

Residual Income (RI) was developed to overcome some of the shortcomings of ROI. Unlike ROI, which is expressed as a percentage, RI measures the absolute amount of income earned above the minimum required return on investment. It incorporates the cost of capital and therefore provides a better indication of value creation.

Residual Income is defined as:

#### ***Divisional Profit less a Capital Charge on Divisional Investment.***

The formula is:

$$\text{RI} = \text{Divisional Profit} - (\text{Required Rate of Return} \times \text{Divisional Investment})$$

A positive RI indicates that the division has earned more than the minimum required return and has created value for the organization.

### **Advantages of Residual Income**

Residual Income encourages managers to accept investments that generate returns above the required rate of return, even if such investments reduce divisional ROI. Consequently, RI promotes goal congruence and shareholder wealth maximization.

Major advantages include:

- It Considers cost of capital.
- It encourages value-creating investments.
- It promotes goal congruence.
- It reduces dysfunctional decision-making.
- It supports shareholder wealth maximization.

### **Disadvantages of Residual Income**

The principal limitation of RI is that it is an absolute measure. Larger divisions are likely to generate higher residual income simply because of their size. Therefore, direct comparison between divisions of different sizes may not be meaningful.

Other limitations include:

- Difficult comparison across divisions.
- Influenced by investment size.
- May still encourage short-term focus.
- Less intuitive than percentage measures.

### **Comparison between ROI and RI**

ROI and RI are the two most commonly used divisional performance measures. ROI focuses on percentage returns and facilitates comparison among divisions, whereas RI emphasizes value creation after considering the cost of capital.

<b>Basis</b>	<b>ROI</b>	<b>RI</b>
Nature	Relative Measure	Absolute Measure
Expression	Percentage	Monetary Amount
Cost of Capital	Ignored	Considered
Goal Congruence	May be weaker	Stronger
Acceptance of New Projects	May reject profitable projects	Encourages profitable projects
Comparison	Easier	More difficult

Thus, many organizations use both ROI and RI together to obtain a balanced assessment of divisional performance.

### **Conclusion**

Divisional Performance Measurement is a critical component of management accounting in decentralized organizations. It enables management to evaluate the effectiveness of divisions, motivate managers, and ensure alignment between divisional and organizational objectives. Decentralization improves responsiveness and managerial development but requires appropriate performance evaluation systems. DuPont Analysis provides a detailed understanding of Return on Equity through profitability, asset utilization, and financial leverage. ROI remains a popular measure due to its simplicity and comparability, while Residual Income addresses many of its shortcomings by incorporating the cost of capital. Together, these

techniques provide a comprehensive framework for assessing divisional performance and promoting long-term organizational success.

### Multiple Choice Questions (MCQs):

- Divisional Performance Measurement is primarily used to:
  - Calculate income tax liability
  - Evaluate the efficiency and effectiveness of divisions
  - Determine market share
  - Prepare financial statements
- Decentralization refers to:
  - Concentration of decision-making at top management
  - Delegation of authority and responsibility to lower-level managers
  - Elimination of management hierarchy
  - Centralization of all functions
- Which of the following is NOT a responsibility centre?
  - Cost Centre
  - Revenue Centre
  - Profit Centre
  - Audit Centre
- According to DuPont Analysis, Return on Equity (ROE) is calculated as:
  - Net Profit Margin  $\times$  Asset Turnover  $\times$  Financial Leverage
  - Net Profit  $\div$  Total Assets
  - EBIT  $\div$  Capital Employed
  - Sales  $\div$  Total Assets
- The Asset Turnover Ratio measures:
  - Profitability of the business
  - Efficiency in using assets to generate sales
  - Liquidity position
  - Financial risk
- A division reports Net Profit Margin of 20%, Asset Turnover of 2 times, and Financial Leverage of 1.5. The Return on Equity (ROE) is:
  - 40%
  - 50%
  - 60%
  - 75%
- Return on Investment (ROI) is generally calculated as:
  - Profit before Interest and Tax  $\div$  Capital Employed  $\times$  100
  - Net Profit  $\div$  Sales  $\times$  100
  - Sales  $\div$  Total Assets  $\times$  100
  - Profit after Tax  $\div$  Equity  $\times$  100
- ROI can be improved by:
  - Improving margin only
  - Improving turnover only
  - Improving both margin and turnover
  - Increasing liabilities only
- Which of the following is a limitation of ROI?
  - It ignores investment size
  - It may encourage short-term decision making
  - It cannot be expressed as a percentage
  - It ignores profit
- Residual Income (RI) is calculated as:
  - Divisional Profit + Capital Charge
  - Divisional Profit – Capital Charge
  - Sales – Variable Cost
  - EBIT – Interest
- If a division earns ₹5,00,000 and the capital charge is ₹3,80,000, Residual Income will be:
  - ₹1,20,000
  - ₹8,80,000
  - ₹3,80,000
  - ₹5,00,000
- Which statement regarding Residual Income is correct?
  - RI ignores cost of capital
  - RI encourages acceptance of projects earning above the required rate of return
  - RI is expressed as a percentage
  - RI cannot be used for performance measurement

### Answer Key

1	2	3	4	5	6	7	8	9	10	11	12
b	b	d	a	b	c	a	c	b	b	a	b

**Fill in the Blanks**

1. The process of delegating authority and responsibility to lower levels of management is called \_\_\_\_\_.
2. DuPont Analysis decomposes Return on Equity into profitability, asset utilization and \_\_\_\_\_.
3. ROI stands for Return on \_\_\_\_\_.
4. Residual Income is calculated by deducting the capital \_\_\_\_\_ from divisional profit.
5. A division that is responsible for profits as well as investment decisions is known as an \_\_\_\_\_ Centre.

**Answer Key**

1	2	3	4	5
Decentralization	Financial Leverage	Investment	Charge	Investment

**State True or False**

1. In a decentralized organization, local managers can respond more quickly to changing conditions.
2. DuPont Analysis helps identify the factors influencing Return on Equity.
3. ROI considers the amount of investment employed in generating profits.
4. Residual Income ignores the cost of capital employed in a division.
5. A project with positive Residual Income should generally be accepted.

**Answer Key**

1	2	3	4	5
T	T	T	F	T

# CMA FINAL COURSE

Syllabus 2022

## Topic

Module 9 :  
Specific Legal  
Provisions related  
to MSME Sector

FINAL

Group III - Paper-13

Corporate and  
Economic Laws  
(CEL)

# Micro, Small and Medium Enterprises Development Act, 2006: Legal Framework, Implementation, and Policy Evolution

## 1. Introduction

The **Micro, Small and Medium Enterprises Development Act, 2006 (MSMED Act)** was enacted with the objective of facilitating the **promotion, development, and competitiveness** of MSMEs in India. MSMEs form the backbone of the Indian economy, contributing approximately **29% to GDP, 40% to exports**, and employing nearly **60% of the workforce**. The Act provides a comprehensive legal framework for their classification, registration, financial assistance, and protection against delayed payments.

### 1.1 Economic Significance of the MSME Sector in India

The **Micro, Small and Medium Enterprises (MSME)** sector occupies a pivotal position in India's economic structure and is widely regarded as the backbone of industrial growth and employment generation. According to recent industry estimates, MSMEs account for nearly **95% of all manufacturing units** in India, contribute approximately **30% of the national Gross Domestic Product (GDP)**, and generate nearly **48–50% of the country's exports**. The sector encompasses more than 6,000 products ranging from *traditional handicrafts and cottage industry goods* to *sophisticated engineering and pharmaceutical products*. Further, MSMEs provide employment to nearly **11 crore persons** across *organised and unorganised non-agricultural sectors*, making them the **second-largest source of employment after agriculture**.

The significance of MSMEs extends beyond economic output. Due to their relatively **low capital requirements** and **labour-intensive nature**, these enterprises play a crucial role in *promoting inclusive growth, reducing regional disparities, and fostering entrepreneurship* in rural and semi-urban areas. MSMEs are particularly prominent in sectors such as *textiles, food processing, chemicals, pharmaceuticals, engineering, automobiles, handicrafts, and cottage industries*. Their ability to adapt quickly to changing market demands often places them at the forefront of innovation and local economic development.

Recognising their contribution, the Government of India has continuously sought to strengthen the sector through legislative and policy interventions. The enactment of the **Micro, Small and Medium Enterprises Development Act, 2006** marked a significant step towards providing a comprehensive legal framework for the promotion, development, and competitiveness of MSMEs. The Act seeks not only to facilitate access to finance and markets but also to address structural challenges such as delayed payments, technological constraints, and inadequate institutional support.

In accordance with the **revised classification notified in 2025** under the MSMED framework, enterprises are categorised based on investment and annual turnover. A **micro enterprise** is one where **investment in plant and machinery or equipment does not exceed ₹2.5 crore** and **turnover remains below ₹10 crore**. A **small enterprise** may **invest up to ₹25 crore** with **turnover not exceeding ₹100 crore**, while a **medium enterprise** may **invest up to ₹125 crore** with **turnover not exceeding ₹500 crore**. These revised criteria aim to promote growth and remove the disincentives that previously discouraged enterprises from expanding beyond prescribed thresholds.

The *growing participation of women entrepreneurs* further highlights the *transformative potential of the MSME sector*. Various government initiatives, including *credit guarantee schemes, procurement support mechanisms, and marketing assistance programmes*, have encouraged greater inclusion of women-led enterprises. Consequently, MSMEs have emerged not merely as economic entities but also as instruments of *social empowerment and sustainable development*.

## 2. Objectives of the MSME Act, 2006

The Act aims to:

- Promote and develop MSMEs to enhance competitiveness.
- Create an enabling environment for entrepreneurship and innovation.
- Ensure **timely credit, technological upgradation, and market access**.
- Provide a **statutory mechanism** for redressal of delayed payments to MSMEs.

## 3. Significance of Classification of Enterprises

Under **Section 7** of the MSME Act, enterprises are classified based on **investment and turnover, mentioned above**. This classification helps determine eligibility for various schemes, benefits, and exemptions.

## 4. Institutional Framework under the Act

### (a) National Board for MSMEs (Sections 3–6)

- Constituted by the Central Government.
- Headed by the Minister of MSME.
- Advises the government on policies, credit flow, technological upgradation, and fund utilization.

### (b) Advisory Committee

- Provides recommendations for classification, investment criteria, and policy formulation.

### (c) Micro and Small Enterprises Facilitation Council (MSEFC) (Sections 18–21)

- Established by State Governments.
- Facilitates conciliation and arbitration for resolving **payment disputes** between buyers and MSMEs.
- Ensures resolution within **90 days** of reference

### 5. Key Provisions of the MSME Act

#### 5.1 Measures for Promotion and Development (Section 9)

- Skill development, technology upgradation, marketing assistance, and cluster development.
- Integration with central and state-level MSME schemes.

#### 5.2 Credit and Finance (Section 10)

- Mandates the **Reserve Bank of India (RBI)** to issue guidelines ensuring timely and adequate credit flow to MSMEs.
- Encourages banks to reduce collateral requirements.

#### 5.3 Procurement Preference (Section 11)

- Government departments and PSUs must procure a certain percentage of goods and services from MSMEs.

#### 5.4 Delayed Payments (Sections 15–23)

- Buyers must make payments within **45 days** of delivery.
- Failure attracts **three times the RBI bank rate** as compound interest.
- Disputes referred to MSEFC have **overriding effect** over other laws.

### 6. Schemes Supporting MSMEs

According to the **Ministry of MSME (2015)** compilation, various schemes under the Act promote capacity building and competitiveness:

Scheme Name	Objective	Type of Assistance
<b>Credit Guarantee Fund (CGTMSE)</b>	Collateral-free loans to MSEs	Up to ₹2 crore
<b>Prime Minister's Employment Generation Programme (PMEGP)</b>	Self-employment and enterprise creation	15–35% subsidy

Scheme Name	Objective	Type of Assistance
<b>Technology and Quality Upgradation Support</b>	Promote energy efficiency and clean technology	25% subsidy
<b>MSE-Cluster Development Programme (MSE-CDP)</b>	Develop common facility centers and infrastructure	70–90% GoI funding
<b>International Cooperation (IC) Scheme</b>	Support participation in global exhibitions	95% airfare/ space rent subsidy
<b>Design and Lean Manufacturing Schemes</b>	Improve productivity and design innovation	60–80% GoI assistance

These schemes directly implement the policy goals envisaged under **Chapter IV** of the **MSME Act**.

### 7. Policy Developments and Challenges for Medium Enterprises

The **NITI Aayog–ASCI Report (2024)** highlights major policy gaps:

- Only **8 of 18 Central schemes** are available to **medium enterprises**, covering merely **17.81% of MSME funds**.
- Key challenges include:
  - Low awareness of government schemes (only 25% awareness among surveyed units).
  - Difficulty in accessing credit and technology centers.
  - Shortage of skilled manpower.
  - Complex compliance burdens.

#### 7.1 Recommendations:

1. **Dedicated Financial Scheme** for medium enterprises with working capital loans up to ₹5 crore.
2. **Technology Integration Centers** (India ME Competence Centres) to promote Industry 4.0 adoption.
3. **R&D Cell for Medium Enterprises** to foster innovation using the Self-Reliant India (SRI) Fund.
4. **Customized Skill Development Programmes** under the ESDP Scheme.
5. **Centralized MSME Portal** dedicated to medium enterprises for streamlined information and application processes.

## 8. Impact and Importance

Beyond its legal and institutional contributions, the MSME Act has supported a sector that serves as a critical driver of *employment generation* and *regional development*. MSMEs, particularly those situated in rural and semi-urban areas, facilitate the decentralisation of industrial activity and contribute significantly to balanced economic growth. Their capacity to generate employment at comparatively low capital costs makes them an indispensable component of India's development strategy. The sector has also witnessed increasing participation by women entrepreneurs, aided by *government procurement policies*, *credit guarantee mechanisms*, and *market-support schemes*. Such developments demonstrate that the MSME framework contributes not only to economic productivity but also to broader goals of *social inclusion* and *equitable development*.

The MSME Act has led to:

- Legal recognition and registration of over **3 crore units** under **Udyam**.

- Institutional mechanisms for dispute resolution (MSEFC).
- Expansion of credit facilities through **CGTMSE** and **SIDBI**.
- Promotion of self-reliant and export-oriented growth under "**Make in India**".

However, to fully realize its potential, the policy framework must evolve to **address medium enterprises**—the most productive yet under-served segment of the MSME sector.

## 9. Conclusion

The **MSME Act, 2006** represents a landmark in India's industrial policy by providing a unified legislative framework for small-scale enterprises. Its focus on **promotion, competitiveness, and protection against payment delays** has strengthened entrepreneurship. Yet, as highlighted by the **NITI Aayog 2024 report**, the need for a **separate policy framework for medium enterprises** is critical to sustain innovation, exports, and employment growth in India's evolving economy.

## Topic

Module 6:  
Equity and Bond  
Valuation and  
Evaluation of  
Performance

FINAL

Group III - Paper-14

Strategic Financial  
Management (SFM)

## Topic: Equity and Bond Valuation and Evaluation of Performance

### • Multiple Choice Questions

1. The current price of XYZ, Inc., is ₹ 40 per share with 1,000 equity shares outstanding. Sales are ₹4,000 and the book value of the firm is ₹10,000. What is the price/sales ratio of XYZ, Inc.?

- A. 0.01.  
B. 4.00.  
C. 10.00.  
D. 40.00.

#### Explanation:

The price/sales ratio is (price per share)/(sales per share) =  $(40)/(4,000/1,000) = 10.0$ . Alternatively, the price/sales ratio may be thought of as the market value of the company divided by its sales, or  $(40 \times 1,000)/4,000$ , or 10.00 again.

So, the correct option is (C).

2. A stock has a required rate of return of 15%, a constant growth rate of 10%, and a dividend payout ratio of 45%. The stock's price-earnings ratio should be:

- A. 9.0 times.  
B. 4.5 times.  
C. 3.0 times.  
D. 1.5 times

#### Explanation:

$$P/E = D/E_1 / (k - g)$$

$$D/E_1 = \text{Dividend Payout Ratio} = 0.45$$

$$k = 0.15$$

$$g = 0.10$$

$$P/E = 0.45 / (0.15 - 0.10)$$

$$= 0.45 / 0.05 = 9.0$$

So, the correct option is (A).

3. Use the following information and the dividend discount model to find the value of GoFlower, Inc.'s, equity shares.

- Last year's dividend was ₹3.10 per share.
- The growth rate in dividends is estimated to be 10% forever.
- The return on the market is expected to be 12%.
- The risk-free rate is 4%.
- GoFlower's beta is 1.1.

- A. ₹ 34.95.  
B. ₹ 26.64.  
C. ₹ 121.79.  
D. ₹ 132.75

#### Explanation:

The required return for GoFlower is  $0.04 + 1.1(0.12 - 0.04) = 0.128$  or 12.8%. The expected dividend is  $(₹3.10) \times (1.10) = ₹3.41$ . GoFlower's equity share is then valued using the infinite period dividend discount model (DDM) as  $(₹3.41)/(0.128 - 0.10) = ₹121.79$ .

So, the correct option is (C).

4. Baker Computer earned ₹6.00 per share last year, has a retention ratio of 55%, and a return on equity (ROE) of 20%. Assuming their required rate of return is 15%, how much would an investor pay for Baker on the basis of the earnings multiplier model?

- A. ₹74.93.  
B. ₹ 40.00.  
C. ₹173.90.  
D. ₹182.25.

#### Explanation:

$$g = \text{Retention} \times \text{ROE} = (0.55) \times (0.2) = 0.11$$

$$P_0/E_1 = 0.45 / (0.15 - 0.11) = 11.25$$

$$\text{Next year's earnings } E_1 = E_0 \times (1+g) = (6.00) \times (1.11) = ₹6.66$$

$$P_0 = 11.25 \times (₹6.66) = ₹74.93$$

So, the correct option is (A).

5. Use the following data to analyse a stock's price earnings ratio (P/E ratio):

- The stock's beta is 1.2.
- The dividend payout ratio is 60%.
- The stock's expected growth rate is 7%.
- The risk-free rate is 6% and the expected rate of return on the market is 13%.

Using the dividend discount model, the expected P/E ratio of the stock is closest to:

- A. 8.1.  
B. 5.4.  
C. 10.0.  
D. 12.1

**Explanation:**

$$k = E_r = R_f + \text{Beta} (R_M - R_f) = 0.06 + (1.2) (0.13 - 0.06) = 0.144$$

$$\text{Dividend payout ratio} = 0.60$$

$$P/E = \text{dividend payout} / (k - g) = 0.6 / (0.144 - 0.07) = 8.1$$

So, the correct option is (A).

6. An analyst gathered the following data:

An earnings retention rate of 40%.

An ROE of 12%.

The stock's beta is 1.2.

The nominal risk-free rate is 6%.

The expected market return is 11%.

Assuming next year's earnings will be ₹4 per share, the stock's current value is closest to:

A) ₹33.32.

B) ₹45.45.

C) ₹26.67.

D) ₹25.25

**Explanation:**

$$\text{Dividend payout} = 1 - \text{earnings retention rate} = 1 - 0.4 = 0.6$$

$$R_s = R_f + \beta (R_M - R_f) = 0.06 + 1.2 (0.11 - 0.06) = 0.12$$

$$g = (\text{retention rate}) \times (\text{ROE}) = (0.4) \times (0.12) = 0.048$$

$$D_1 = E_1 \times \text{payout ratio} = ₹4.00 \times 0.60 = ₹2.40$$

$$\text{Price} = D_1 / (k - g) = ₹2.40 / (0.12 - 0.048) = ₹33.32.$$

So, the correct option is (A).

7. Assume that at the end of the next year, Company A will pay a ₹2.00 dividend per share, an increase from the current dividend of ₹1.50 per share. After that, the dividend is expected to increase at a constant rate of 5%. If an investor requires a 12% return on the stock, what is the value of the share?

A. ₹30.00.

B. ₹28.57.

C. ₹31.78.

D. ₹32.85

**Explanation:**

$$P_0 = D_1 / k - g$$

$$D_1 = ₹ 2$$

$$g = 0.05$$

$$k = 0.12$$

$$P_0 = 2 / 0.12 - 0.05 = 2 / 0.07 = ₹28.57$$

So, the correct option is (B).

8. Assume that a stock paid a dividend of ₹1.50 last year. Next year, an investor believes that the dividend will be 20% higher and that the stock will be selling for ₹50 at year-end. Assume a beta of 2.0, a risk-free rate of 6%, and an expected market return of 15%. What is the value of the stock?

A) ₹45.00.

B) ₹41.77.

C) ₹40.32.

D) ₹38.56

**Explanation:**

Using the Capital Asset Pricing Model, we can determine the discount rate equal to  $0.06 + 2 \times (0.15 - 0.06) = 0.24$ . The dividends next year are expected to be  $₹1.50 \times 1.2 = ₹1.80$ . The present value of the future stock price and the future dividend are determined by discounting the expected cash flow at the discount rate of 24%:  $(50 + 1.8) / 1.24 = ₹ 41.77$ .

So, the correct option is (B).

- **Comprehensive Problems**

1. Star Limited intends to pay a ₹1 dividend per share next year. Also, assume the required rate of return on Star Limited's share is 10%. Currently, Star Ltd.'s share is trading at ₹10 per share. Further, assume that during the next few years Star Limited's dividends will increase rapidly and then grow at a stable rate. Next year's dividend is still expected to be ₹1 per share, but dividends will increase annually by 7%, then 10%, then 12%, and then steadily increase by 5% after that. Compute the intrinsic value and fair value of Star Limited's share.

**Solution:**

Current fair value of the stock

$$D_1 = ₹1.00$$

$$k = 10\%$$

$$g_1 (\text{dividend growth rate, year 1}) = 7\%$$

$$g_2 (\text{dividend growth rate, year 2}) = 10\%$$

$$g_3 (\text{dividend growth rate, year 3}) = 12\%$$

$$g_n (\text{dividend growth rate thereafter}) = 5\%$$

Since we have estimated the dividend growth rate, we can calculate the actual dividends for

those years:

$$D_1 = ₹1.00$$

$$D_2 = ₹1.00 * 1.07 = ₹1.07$$

$$D_3 = ₹1.07 * 1.10 = ₹1.18$$

$$D_4 = ₹1.18 * 1.12 = ₹1.32$$

We then calculate the present value of each dividend during the unusual growth period:

$$₹1.00 / (1.10) = ₹ 0.91$$

$$₹1.07 / (1.10)^2 = ₹ 0.88$$

$$₹1.18 / (1.10)^3 = ₹0.89$$

$$₹1.32 / (1.10)^4 = ₹0.90$$

Then, we value the dividends occurring in the stable growth period, starting by calculating the fifth year's dividend:

$D_5 = ₹1.32 * (1.05) = ₹1.39$ . We then apply the stable-growth Gordon Growth Model formula to these dividends to determine their value in the fifth year:  $₹1.39 / (0.10 - 0.05) = ₹27.80$ .

The present value of these stable growth period dividends is then calculated:

$$₹27.80 / (1.10)^5 = ₹17.26$$

Finally, we can add the present values of Star Limited's future dividends to arrive at the current intrinsic value of Star Limited stock:

$$₹0.91 + ₹0.88 + ₹0.89 + ₹0.90 + ₹17.26 = ₹20.84.$$

The multistage growth model also indicates that Sky Limited stock is undervalued (a ₹20.84 intrinsic value, compared with a ₹10 trading price).

## Topic

Module 12:  
Double Taxation  
and Avoidance  
Agreements (DTAA)  
[Sec.90. 90A and  
91]

FINAL

Group III - Paper-15

Direct Tax Laws  
and International  
Taxation (DIT)

## Double Taxation Avoidance Agreement

In a taxpayer's home country, tax is generally viewed as an obligation, whereas in a host country, it is often perceived as an additional cost. The phenomenon of "Double Taxation" occurs when an individual or a business is taxed twice on the exact same income in two or more jurisdictions. As economies go global and economic borders blur, this dual tax burden remains one of the major obstacles to the development of inter-country economic relations and international trade.

This hardship typically arises from conflicting domestic tax laws and regulations between nations. Most commonly, it happens when one country levies tax based on the *source* of the income, while another country taxes the same income based on the taxpayer's *residential status*.

E.g., Mr. X, an ordinarily resident in India, earns bank interest of ₹ 1,00,000 on his money deposited into a bank located in the US. In this scenario, the income is taxable in the US based on the source of the income. It is simultaneously taxable again in India, as Mr. X's global income is taxable due to his status as an ordinarily resident in India.

To effectively analyze double taxation and apply appropriate relief measures, it is classified into two primary forms:

- **Juridical Double Taxation:** This occurs when the *same person* is taxed on the *same income* in more than one country.
- **Economic Double Taxation:** This occurs when the *same income* is taxed in the hands of *more than one taxpayer* (for example, corporate profits taxed in the hands of a company, and again when distributed to shareholders).

### Introduction to Double Taxation Avoidance Agreements (DTAA)

DTAA, also known as tax treaties, are bilateral agreements between two countries aimed at preventing double taxation and promoting cooperation in tax matters. These agreements delineate the taxing rights of each country concerning various types of income, such as dividends, interest, royalties, and capital gains.

### Significance of DTAA

DTAA serves several significant purposes:

- **Preventing Double Taxation:** The primary purpose of DTAA is to eliminate or mitigate double taxation,

thereby promoting cross-border trade, investment, and economic activities.

- **Promoting Investment:** By providing certainty and clarity on tax matters, DTAA encourages foreign investment by reducing the tax burden on investors and businesses operating across borders.
- **Facilitating Exchange of Information:** DTAA facilitates the exchange of information between tax authorities of different countries, promoting transparency and combating tax evasion and avoidance.

### Key Components of DTAA

DTAA typically includes the following key components:

- **Residency Rules:** Defines the criteria for determining an individual's tax residency status, which is essential for determining the country's right to tax.
- **Permanent Establishment (PE):** Establishes the threshold for determining when business activities in one country constitute a permanent establishment, subject to taxation in that country.
- **Taxation of Various Income Sources:** Specifies the rules for taxing different types of income, such as dividends, interest, royalties, and capital gains, ensuring that each country has the right to tax certain types of income.
- **Tax Rates and Tax Credits:** Prescribes the applicable tax rates for various types of income and provides mechanisms for granting tax credits or exemptions to prevent double taxation.
- **Mutual Agreement Procedure (MAP):** Sets out procedures for resolving disputes between tax authorities of the treaty countries and ensuring the consistent application of the treaty provisions.

### Mode of providing relief

As per Article 2 of the Vienna Convention on Laws of Treaties, 1969, "Treaty" means an international agreement concluded between States in written form and governed by international law, whether embodied in a single instrument or in two or more related instruments and whatever its particular designation. The two countries' government agrees to provide relief against double taxation of the same income. The relief is granted based on the terms of such agreement. Generally, such an agreement provides relief through the following methods:

Category	Relief Method	Mechanism / Description
⊖ Exemption Method	🚫 <b>Full Exemption</b>	Income earned in the State of Source is fully exempt from tax in the State of Residence.
	📊 <b>Exemption with Progression</b>	Income from the State of Source is exempt but is considered by the State of Residence only for the purpose of determining the applicable tax slab or rate.
📦 Credit Method	💰 <b>Full Credit</b>	The total tax paid in the State of Source is allowed as a full credit against the tax payable in the State of Residence.
	⚖️ <b>Ordinary Credit</b>	The State of Residence allows credit for the tax paid in the State of Source, but it is restricted to that part of the income tax which is attributable to the income taxable in the State of Residence.
	📁 <b>Tax Sparing</b>	The State of Residence allows a credit for <i>deemed</i> tax paid on income which is otherwise exempt from tax in the State of Source (typically used to preserve investment incentives).
	🏢 <b>Underlying Tax Credit</b>	A method that attempts to mitigate <i>economic double taxation</i> (where the same income is taxed in the hands of different persons, such as a company and its shareholders) by allowing credit for corporate taxes paid by a foreign subsidiary.

DTAA can be of two types, limited or comprehensive. Limited DTAA are those which are limited to certain types of incomes only e.g. DTAA between India and Pakistan is limited to shipping and aircraft profits only. Comprehensive DTAA are those which cover almost all types of incomes covered by any model convention.

#### Mode of Providing Relief under Indian Law

- **Section 90:** Relief where India has a DTAA.
- **Section 90A:** Relief where agreement is with specified associations outside India.
- **Section 91:** Unilateral relief where no DTAA exists.

**Note:** As per Section 90(2), if DTAA provisions are more beneficial to the taxpayer compared to domestic law, DTAA provisions prevail.

#### Impact on Taxpayers and Businesses

DTAA has a profound impact on taxpayers and businesses engaged in cross-border transactions:

- **Reduced Tax Liability:** Taxpayers benefit from reduced tax liability on income derived from foreign sources, as DTAA often lowers the withholding tax rates on dividends, interest, royalties, and other income.
- **Certainty and Predictability:** Businesses enjoy greater certainty and predictability regarding their tax obligations in foreign jurisdictions, enabling better tax planning and investment decisions.
- **Enhanced Compliance:** DTAA promotes compliance with tax laws by providing clear rules and procedures for determining tax liability, reducing the risk of unintentional non-compliance.
- **Dispute Resolution:** The inclusion of a Mutual Agreement Procedure (MAP) in DTAA provides a mechanism for resolving disputes between taxpayers and tax authorities, ensuring fair and impartial resolution of tax disputes.

Impact	Description
Lower Withholding Taxes	Reduced taxes on cross-border payments.
Greater Certainty	Assured taxation framework for foreign investments.
Enhanced Compliance	Promotes adherence to international and domestic laws.
Avoidance of Litigation	Provides alternate dispute resolution through MAP.

#### Conclusion

The Double Taxation Avoidance Agreement plays a pivotal role in ensuring fairness and equity in international taxation by protecting taxpayers from dual tax burdens and providing a clear mechanism for taxing cross-border incomes. With the advent of evolving global tax practices, the Indian DTAA framework has proactively adapted to combat aggressive tax planning. Most notably, the integration of the OECD's **Base Erosion and Profit Shifting (BEPS)** action plans and the adoption of the **Multilateral Instrument (MLI)** have fundamentally upgraded traditional bilateral treaties. These modern frameworks introduce robust anti-abuse rules such as the Principal Purpose Test (PPT) and enhance the exchange of information to strike a balance between safeguarding national tax revenue and facilitating legitimate international trade. Consequently, an effective understanding and strategic application of these modernized DTAA provisions are now indispensable for global business operations, international investments, and compliant tax planning strategies.

## Topic

Module 4:  
Activity Based  
Management and  
Just in Time (JIT)

## FINAL

### Group III - Paper-16

### Strategic Cost Management (SCM)

## Activity-Based Costing (ABC)

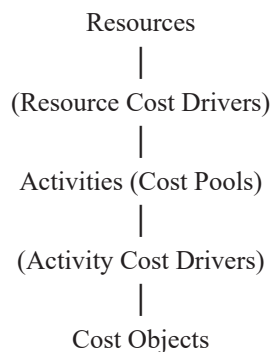
In traditional costing systems, manufacturing overheads are typically allocated using broad volume-based measures such as direct labour hours or machine hours. These allocation methods often fail to reflect the actual consumption of organizational resources, resulting in **product cost distortion**. Consequently, organizations may experience inaccurate product costing, inappropriate pricing decisions, and misleading profitability analysis.

**Activity-Based Costing (ABC)** addresses these shortcomings by allocating costs based on the activities that consume organizational resources. The underlying principle of ABC is:

**Resources are consumed by activities, and activities are consumed by products or services.**

This approach provides more accurate cost information, enabling better strategic decision-making, pricing, budgeting, and process improvement.

The ABC system traces costs through a structured sequence that links resources, activities, and cost objects.



### 1. Resources

Resources represent the economic inputs consumed by an organization, such as labour, machinery, utilities, depreciation, and factory space.

### 2. Activities

Activities are specific tasks or operations performed within the organization that consume resources.

**Examples:**

- Machine setup
- Purchase order processing
- Quality inspection
- Material handling

### 3. Cost Pools

A cost pool is a logical grouping of costs associated with a particular activity. Instead of combining all overheads into one large pool, ABC creates multiple activity-specific cost pools.

**Examples:**

- Setup Cost Pool
- Inspection Cost Pool
- Material Handling Cost Pool
- Purchasing Cost Pool

### 4. Cost Objects

A cost object is any product, service, customer, project, or business segment for which a separate cost measurement is required.

**Examples:**

- Product line
- Customer segment
- Distribution channel
- Special project

### Cost Drivers in ABC

Cost drivers establish the relationship between resources, activities, and cost objects.

#### A. Resource Cost Drivers

These drivers allocate resource costs to various activities.

**Examples:**

- Floor area occupied
- Employee working hours
- Machine usage
- Power consumption

#### B. Activity Cost Drivers

These drivers allocate activity costs from cost pools to cost objects.

**Examples:**

- Number of machine setups
- Number of purchase orders
- Inspection hours
- Number of production batches

### Cost Hierarchy under Activity-Based Costing

ABC classifies activities into different hierarchical levels depending on how costs behave with changes in production.

#### 1. Unit-Level Activities

These activities are performed each time an individual unit is produced. Their costs vary directly with production volume.

**Examples:**

- Direct material usage
- Direct labour operations

**2. Batch-Level Activities**

These activities are performed once for each production batch, irrespective of the number of units within that batch.

**Examples:**

- Machine setup
- Purchase order processing
- Batch quality inspection

**3. Product-Sustaining Activities**

These activities support an entire product line and remain unaffected by the number of units or batches produced.

**Examples:**

- Product design
- Engineering modifications
- Product testing
- Technical documentation

**4. Facility-Sustaining Activities**

These activities support the overall manufacturing facility and cannot be directly traced to individual products.

**Examples:**

- Factory rent
- Plant security
- Building maintenance
- Factory administration

**Traditional Costing vs. Activity-Based Costing**

Basis of Comparison	Traditional Costing	Activity-Based Costing (ABC)
<b>Overhead Allocation</b>	Uses a single plant-wide or departmental overhead pool.	Uses multiple activity-specific cost pools.
<b>Allocation Base</b>	Primarily volume-based measures such as labour hours or machine hours.	Employs both volume-based and activity-based cost drivers.

Basis of Comparison	Traditional Costing	Activity-Based Costing (ABC)
<b>Cost Accuracy</b>	May overcost high-volume products and undercost complex, low-volume products.	Accurately reflects actual resource consumption by each product or service.
<b>Cost Drivers</b>	Limited to one or two allocation bases.	Multiple cost drivers representing different organizational activities.
<b>Strategic Use</b>	Mainly designed for financial reporting and inventory valuation.	Supports pricing, profitability analysis, process improvement, and strategic decision-making.
<b>Decision-Making</b>	Provides limited managerial insights.	Facilitates informed operational and strategic decisions.

**Advantages of Activity-Based Costing**

- Provides more accurate product and service costing.
- Improves pricing and profitability decisions.
- Identifies non-value-added activities for cost reduction.
- Enhances budgeting and performance evaluation.
- Supports strategic cost management and continuous improvement.
- Enables better understanding of resource consumption.

**Limitations of Activity-Based Costing**

- Implementation can be expensive and time-consuming.
- Requires detailed data collection and analysis.
- Maintaining multiple cost pools increases administrative effort.
- May not be cost-effective for small organizations with simple production processes.

**Problem 1:**

**Alpha Precision Industries Ltd.** manufactures two industrial products:

- **Product A (Economy Model)**
- **Product B (Premium Model)**

The company's total manufacturing overheads amount to ₹24,00,000.

The existing costing system allocates overheads using **machine hours**. However, a detailed operational study indicates that overheads arise from three major activities:

Activity	Cost	Cost Driver
Machine Setup	₹8,40,000	Number of Setups
Quality Testing	₹9,60,000	Number of Inspections
Material Handling	₹6,00,000	Number of Material Moves

The production data are given below:

Particulars	Product A	Product B	Total
Annual Production (Units)	12,000	3,000	15,000
Machine Hours per Unit	2	4	—
Number of Setups	30	50	80
Number of Inspections	40	80	120
Number of Material Moves	50	100	150

**Direct costs per unit:**

Particulars	Product A	Product B
Direct Material	₹200	₹500
Direct Labour	₹100	₹250

The company follows a policy of earning a 20% profit on total cost while fixing the selling price.

**Required**

1. Compute the overhead cost per unit using the traditional costing method.
2. Compute the overhead cost per unit using Activity-Based Costing (ABC).
3. Determine the **selling price per unit** of Product A and Product B under the **Traditional Costing** method.
4. Determine the **selling price per unit** of Product A and Product B under the **Activity-Based Costing (ABC)** method.
5. Analyse the product cost and selling price distortion under the traditional costing system

**Solution:**

1. Computation of overhead cost under **Traditional Costing**

**Machine Hours**

Product A = 12,000 × 2 = 24,000 hours

Product B = 3,000 × 4 = 12,000 hours

Total Machine Hours = 36,000 hours

**Overhead Absorption Rate**

= ₹24,00,000/36,000 = ₹66.67 per machine hour

**Overhead Allocation**

Product A = 24,000 × 66.67 = ₹16,00,000

Per unit = ₹16,00,000 / 12,000 = **₹133.33**

Product B = 12,000 × 66.67 = ₹8,00,000

Per unit = ₹ 8,00,000 / 3,000 = **₹266.67**

2. Computation of overhead cost under **Activity-Based Costing**

(i) **Setup Rate** = 8,40,000/80 = ₹10,500 per setup

(ii) **Inspection Rate** = 9,60,000/120 = ₹8,000 per inspection

(iii) **Material Handling Rate** = 6,00,000/150 = ₹4,000 per material move

**Activity Allocation**

Activity	Product A	Product B
Machine Setup	30 × 10,500 = ₹3,15,000	50 × 10,500 = ₹5,25,000
Quality Testing	40 × 8,000 = ₹3,20,000	80 × 8,000 = ₹6,40,000
Material Handling	50 × 4,000 = ₹2,00,000	100 × 4,000 = ₹4,00,000
<b>Total Overhead</b>	<b>₹8,35,000</b>	<b>₹15,65,000</b>

**ABC Cost per Unit**

Product A = ₹8,35,000/12,000 = **₹69.58 per unit**

Product B = ₹15,65,000/3,000 = **₹521.67 per unit**

**Step 3: Cost Distortion Analysis**

Product	Traditional Cost/Unit	ABC Cost / Unit	Distortion
Product A	₹133.33	₹69.58	Over-costed by ₹63.75 per unit
Product B	₹266.67	₹521.67	Under-costed by ₹255.00 per unit

**3. Selling Price under Traditional Costing**

Product A

Particulars	Amount (₹)
Direct Material	200.00
Direct Labour	100.00
Overhead (Traditional)	133.33
Total Cost	433.33
Profit (20%)	86.67
Selling Price	₹520.00

## Product B

Particulars	Amount (₹)
Direct Material	500.00
Direct Labour	250.00
Overhead (Traditional)	266.67
Total Cost	1,016.67
Profit (20%)	203.33
Selling Price	₹1,220.00

## 4. Selling Price under Activity-Based Costing

## Product A

Particulars	Amount (₹)
Direct Material	200.00
Direct Labour	100.00
ABC Overhead	69.58
Total Cost	369.58
Profit (20%)	73.92
Selling Price	₹443.50

## Product B

Particulars	Amount (₹)
Direct Material	500.00
Direct Labour	250.00
ABC Overhead	521.67
Total Cost	1,271.67
Profit (20%)	254.33
Selling Price	₹1,526.00

## Summary of Selling Prices

Product	Traditional Selling Price (₹)	ABC Selling Price (₹)
Product A	520.00	443.50
Product B	1,220.00	1,526.00

## 5. Interpretation:

The traditional costing system allocates overheads solely on the basis of machine hours, resulting in cost distortion by over-costing the high-volume **Product A** and under-costing the low-volume, operationally complex **Product B**. Consequently, the selling prices determined under the traditional method are also distorted, with Product A being priced higher than necessary and Product B being priced lower than its actual cost warrants. In contrast, Activity-Based Costing (ABC) allocates overheads based on the actual consumption of activities, resulting in more accurate product costs, appropriate selling prices, reliable profitability analysis, and improved strategic decision-making.

## Problem 2:

**Vertex Supply Chain Solutions Ltd.** distributes industrial equipment to two major institutional customers:

- **Customer Alpha**
- **Customer Beta**

During the year, both customers generated identical annual sales revenue of **₹6,00,00,000** each. The cost of goods sold (COGS) attributable to each customer amounted to **₹4,20,00,000**.

The company's annual customer support overhead totals **₹72,00,000**, which arises from the following customer service activities:

Customer Support Activity	Cost Pool (₹)	Cost Driver
Order Processing	₹18,00,000	Number of Purchase Orders
Priority Deliveries	₹30,00,000	Number of Express Deliveries
Returns Processing	₹24,00,000	Number of Return Shipments

The annual customer activity data are as follows:

Activity Driver	Customer Alpha	Customer Beta	Total
Purchase Orders	200	800	1,000
Express Deliveries	30	170	200
Return Shipments	20	100	120

Under the traditional costing system, customer support overheads are allocated **equally between the two customers**.

## Required

1. Prepare the customer profitability statement under the traditional costing system.
2. Prepare the customer profitability statement using Activity-Based Costing (ABC).
3. Comment on the results obtained.

## Solution:

## 1. Traditional Costing

## Overhead Allocation

Total Customer Support Overheads = ₹72,00,000

Allocated equally = ₹72,00,000/2 = ₹36,00,000

**Customer Profitability Statement**

Particulars	Customer Alpha (₹)	Customer Beta (₹)
Sales Revenue	6,00,00,000	6,00,00,000
Less: Cost of Goods Sold	(4,20,00,000)	(4,20,00,000)
<b>Gross Margin</b>	<b>1,80,00,000</b>	<b>1,80,00,000</b>
Less: Allocated Support Overheads	(36,00,000)	(36,00,000)
<b>Net Customer Profit</b>	<b>₹1,44,00,000</b>	<b>₹1,44,00,000</b>

**2. Activity-Based Costing****Step 1: Activity Cost Driver Rates**

Order Processing = ₹18,00,000/1,000 = ₹1,800 per order

Priority Delivery = ₹30,00,000/200 = ₹15,000 per delivery

Returns Processing = ₹24,00,000/120 = ₹20,000 per return

**Step 2: Allocation of Activity Costs**

Activity	Customer Alpha (₹)	Customer Beta (₹)
Order Processing	200 × 1,800 = 3,60,000	800 × 1,800 = 14,40,000
Priority Deliveries	30 × 15,000 = 4,50,000	170 × 15,000 = 25,50,000
Returns Processing	20 × 20,000 = 4,00,000	100 × 20,000 = 20,00,000
<b>Total Customer Overheads</b>	<b>₹12,10,000</b>	<b>₹59,90,000</b>

**Customer Profitability Statement (ABC)**

Particulars	Customer Alpha (₹)	Customer Beta (₹)
Sales Revenue	6,00,00,000	6,00,00,000
Less: Cost of Goods Sold	(4,20,00,000)	(4,20,00,000)
<b>Gross Margin</b>	<b>1,80,00,000</b>	<b>1,80,00,000</b>
Less: Customer Support Overheads	(12,10,000)	(59,90,000)
<b>Net Customer Profit</b>	<b>₹1,67,90,000</b>	<b>₹1,20,10,000</b>

**3. Interpretation**

Under the traditional costing system, both customers appear to be equally profitable because customer support overheads are allocated uniformly. However, the Activity-Based Costing (ABC) system reveals that **Customer Beta** consumes substantially more customer support activities, such as purchase order processing, priority deliveries, and returns handling, resulting in significantly higher service costs. Consequently, **Customer Alpha** is more profitable than indicated by the traditional system, while **Customer Beta** is less profitable. ABC provides a more accurate assessment of customer profitability and supports better decisions regarding pricing, customer relationship management, and resource allocation.

## Topic

Module 6:  
Cost Audit  
Programme

FINAL

Group IV - Paper-17

Cost and  
Management Audit  
(CMAD)

## Cost element-wise detail Programme

### Cost element-wise detail Programme:

Sl. No.	Elements of Cost
1	Audit of Production -Product wise
2	Audit of Raw Material Cost
3	Audit of Key RM Inventory status
4	Audit of Electricity Cost
5	Audit of cost of electricity generated by DG (Diesel Generator)
6	Audit of Demineralised water cost
7	Audit of Steam Cost
8	Audit of Stores and Spares cost
9	Audit of Repair and ,maintenance cost
10	Audit of Employee cost
11	Audit of insurance cost
12	Audit of Depreciation cost
13	Audit of Administrative Cost
14	Audit of selling and distribution cost
15	Audit of packing material cost
16	Audit of sales value

#### 1. Audit of Production –Product-wise

- o Whether appropriate cut-offs are observed to identify calendar dates with stages of production?
- o Whether organizational guideline is in place to identify percentage completion in different product stages?
- o Whether Finished products, Work In Progress -WIP ( SFG Semi Finished Goods) are segregated and considered Accordingly?
- o Whether products manufactured and capacity available are compared to find out utilization?
- o Whether only Quality approved products are declared as ‘production’ and considered for further analysis?
- o Whether any incremental capacity reckoned for actual product-wise higher output?
- o Whether technological improvement caused higher product-wise output?
- o Whether efficiency enhancement of labour force resulted in higher output?
- o Whether production tracking over a period of time (say 5-years) captured for further analysis?

#### 2. Audit of Raw Material (RM)Cost

- o Whether BOM ( Bill Of Materials) includes every element/item required to carry out Production with Product-wise details.
- o Whether a Budget with expected price is made for all key raw material?
- o Whether any subsequent changes in BOM are updated for considering consumption?
- o Whether a variance analysis is carried out at periodical intervals to assess actual cost is within a reason level?
- o Whether high difference is analysed to pre-empt any possibility to avoid/reduce such implications?
- o Whether receipting process is in place and inventory updation carried out on real time basis?
- o Whether storage is made appropriately without any possibility of mix-up, spilling over and losses due to airborne?
- o Whether inventory movements are made against approvals of appropriate authority?
- o Whether raw materials including bulks are issued for consumption/kept in storage against a proper method of measurement?
- o Whether perpetual and/or quarterly physical verification process is in place?
- o Whether the difference between Book Stock and physical stock adjusted in the relevant period of accounting?
- o Whether the Ordering process considers , (a) EOQ (b) Lead Time ( c ) effective life of RM etc.
- o Whether the entity having a policy to identify slow and non-moving raw materials and fixing level for provision against such items?
- o Whether a material codification logic is followed for identification of imported and local raw materials ( having similar look but difference in price and effectiveness)?
- o Whether abnormal loss of material is appropriately treated?

#### 3. Audit of Key RM Inventory Status

- o Whether by value or volume the list of materials qualified as ‘key’ Raw Material ?
- o Whether the entity having a stocking /holding policy for such items for continuity of production?

- o Whether the prevalent consumption pattern justifies the pre-determined inventory holding policy?
- o Whether any improvement in lead time, delivery conditions etc. explored to reduce the volume at hand/yard?
- o Whether low inventory ever caused production stoppages?
- o Whether comparison made for holding cost over a period of time (say 3-years)?

#### 4. Audit of Electricity Cost

- o Whether all Cost Centres (Production and Utility) are mapped for electricity consumption, e.g Kiln, Grinding, Packer (Production) and Air Compressor, Chilling Plant etc. (Utilities)
- o Whether Electricity consumption standard and required heat is mapped against each of the facilities.
- o Whether actual electricity consumption is in tandem with output/Production from each of the facility e.g Packing Volume vs. electricity consumption, Kiln consumption vs. Clicker produced, Grinding Mill electricity consumption vs. Cement manufactured.
- o Whether difference between actual consumption and Standard mapped and reason for such differences are validated.
- o Whether self-generation of electricity for captive consumption and buying are appropriately metered and allocated to cost centres.
- o Whether calibration and certification thereof obtained for entire metering process.
- o Whether appropriate allocation methodology is followed for common area of consumption.
- o Whether source-wise electricity cost is analysed for appropriate cost allocation and product-wise absorption purposes.
- o Whether cost trend over a period (say 5-years) is analysed planning power cost scenario and possible requirement of Capex in the area.

#### 5. Audit of Electricity Cost 'Diesel Generator'

- o Whether fuel (diesel), repair and maintenance and other running expenses are captured and monitored properly?
- o Whether DG run Hours and purpose are recorded?
- o Whether record for units generated and purpose of usage are maintained?

- o Whether meter readings are recorded at specified periods?
- o Whether fuel consumption vs. units generated are maintained over a period to measure (a) fuel efficiency (b) DG efficiency
- o Whether appropriate consumption points are mapped and DG distributes electricity accordingly?
- o Whether consumables are properly allocated and certified as usage to run DG Facility.
- o Whether depreciation and other overheads are charged to appropriate Machine (where multiple DGs are used)
- o Whether calibration of meters and reading accuracy is ensured?
- o Whether DG Cost and other source-wise cost is captured, compared to assess alternate possibilities?

#### 6. Audit of Demineralized Water (DM) cost

- o Whether allotment of 'Cost Centre' and capturing of cost is carried out properly?
- o Whether element-wise cost with volume of consumption is maintained?
  - Volume of filtered water
  - Volume of chemicals
  - Electricity used in TP (Treatment Plant)
- o Whether volume of DM Water generated are captured correctly?
- o Whether use points are mapped and consumption of DM Water captured appropriately?
- o Whether a proper cost structure is in place and DM Water consumption data ensures accuracy?
- o Whether all relevant cost including depreciation captured in DM Water Cost Centre?

#### 7. Audit of steam cost

- o Whether running hours of Boiler and Steam generated are (Mt.) are recorded?
- o Whether all relevant Boiler running expenses/consumptions like DM Water (Ltr.), Electricity (KWH), Fuel (Light Diesel Oil, Coal (Mt.), Steam consumption etc. are recorded and maintained.
- o Whether line losses are measured for future corrective actions.
- o Whether standard requirement (Mt.) of Product (Mt.) are compared for any probable variance.

- o Whether high consumption areas are covered by Meters and meter readings obtained at fixed intervals.
- o Whether consumption variance ,if any, is analysed for understanding the reason (e.g leakage in pipe lines, erroneous reading of meters, inactive meters etc.)
- o Whether manpower cost, consumables and other Boiler House related cost (e.g., repair, maintenance etc.) are booked timely and correctly.

#### 8. Audit of Stores and Spares cos

- o Whether Cost Centre-wise Requisition for Spares are maintained to arrive at total requirement of Spares at Unit/Entity level.
- o Whether to support the above and to avail 'price advantage', appropriate codification logic is in place?
- o Whether Spares are classified under A,B , C Category to exercise proper supervision and control.
- o Whether there exists any organizational Guideline to differentiate between Slow, Non-moving spares based yearly consumption history?
- o Whether appropriate valuation methodology exists for Stores and Spares falling under Slow, Non-moving category?
- o Whether Product-wise , Plant-wise, Cost Centre-wise Spares issues and consumption are tracked?
- o Whether accounting guidance for recording Stores and Spares to appropriate 'cost centres' / 'Plants' in place?
- o Whether the 'Spares Control Account' is reflected in Trial Balance and tallied.

#### 9. Audit of Repairs and Maintenance Cost

- o Whether Repair and Maintenance Costs are attached/tied against each of the 'Cost Centres'?
- o Whether age of plant along-with 'Repair Maintenance expenditure '(R&M spent trending higher) compared to 'Plant Value and remaining life' decide on replacement of the asset.
- o Whether all 'R&M Expenditure' booked to appropriate 'cost centres'?
- o Whether 'Repair and Maintenance cost' per Mt. of Product indicating a 'rising, falling or constant' trend?

- o Whether a 'R&M Budget' is prepared to keep the expenses within the limit?
- o Whether 'R&M Cost' is bifurcated into "Normal, Special, Shut-down, Break-down "etc. to have (R&M) better visibility on normal and abnormal Cost hike.

#### 10. Audit of employee Cost

- o Whether Employees whose names are appearing in the 'pay roll 'only considered for 'employee cost'?
- o Whether permanent deployment with contractual pay, also clubbed as 'employee cost'?
- o Whether employees are tagged against each of the 'cost centre' whereby cost centre-wise 'pay roll' cost can be validated?
- o Whether any employee movement, A-D-C (Addition-Deletion-Change) tracked immediately against relevant 'cost centre'?
- o Whether 'product cost build up' considers 'cost centre-wise' employee cost ?
- o Whether trend analysis is carried out for employee cost captured over a period?
- o Whether such trend indicated employee performance improvement overriding 'inflationary / statutory increases'?
- o Whether industry-wide bench marking applied for 'employee cost' of the relevant industry?
- o Whether 'employee cost' as percentage of product cost analysed for cost reduction/ minimization purposes?

#### 11. Audit of insurance Cost

- o Whether 'cost centre-wise' Assets are identified and tagged?
- o Whether abovesaid Assets are covered against insurable perils obtaining appropriate policy cover under individual policy or 'umbrella policy'?
- o Whether Premia cost against each of the Asset/ Cost Centre are identifiable and captured?
- o Whether new assets are also covered immediately and premia cost allocated to appropriate asset cost centre?
- o Whether 'cost centre-wise' insurance cost allocation being checked and any Y-O-Y variance can be validated with proper reasoning?
- o Whether monetary impact of insurance cost with product-wise absorption compared for product cost movement purposes?

- o Whether impact of changed output considered to measure movement of 'product-wise insurance' cost?

## 12. Audit of depreciation Cost

- o Whether 'Cost Centre-wise' Assets are identified and depreciation against those are captured for the period under review?
- o Whether new installations are mapped and considered on the depreciation schedule?
- o Whether 'product cost' includes depreciation as per aforesaid calculation?
- o Whether individual asset performance and remaining life considered for depreciation assessed?
- o Whether reason for sudden increase or decrease in depreciation cost w.r.t 'cost centre' /s analysed for the 'root cause'?

## 13. Audit of administrative overhead Cost

- o Whether specific guideline is available for the heads of expenditure to be considered as 'Administrative Overhead'?
- o Whether Year-wise administrative cost break-up is available w.r.t Product, Cost Centre ?
- o Whether allocation / apportionment of administrative expenses are carried out logically and consistently the same followed?
- o Whether any abnormal increase/decrease noticed in administrative overhead cost and also in the Product?

## 14. Audit of selling & distribution O/H Cost

- o Whether categorization of Selling and Distribution (S&D) cost available at the organizational level and Product, cost centre-wise also?
- o Whether Selling and Distribution cost at product level as a percentage of COGS is fixed?
- o Whether Y-O-Y (year on year) S&D Cost trend over a period is analyzed to get feedback on the responsible account head, where expenditure trend is much higher/lower than anticipated?
- o Whether sound logic-based allocation / apportionment principle is followed for overhead cost division?
- o Whether the principle followed for allocation/ apportionment is consistently followed year after year?

- o Whether per Unit increase/decrease in S&D Cost at each of the Product level considered for 'price fixation'?
- o Whether infrastructural improvement and/or change in sales policy evaluated for increase/decrease of S & D Expenditure.

## 15. Audit of Packing Material Cost

- o Whether Primary and Secondary Packing Materials are identified based on usage purpose?
- o Whether special packing opted by bulk buyers are recovered via Invoice Price?
- o Whether proper consumption record is maintained and the same compared with standard set for Packing Materials?
- o Whether any abnormality being noticed in the Packer , which resulted in high abnormal consumption of packing materials.
- o Whether quality of packing materials ensured before they issued to 'shop floor' for consumption.
- o Whether consumption trend is examined for the Products which are 'key products' at least for last five years.
- o Whether packing material rates , examined for last few years ( say five) and how packing materials can be replaced to withstand price pressure.
- o Whether separate codification logic is followed for 'self-produced' packing materials and cost for the same.
- o Whether Inventory records are maintained for above 'self-produced' items w.r.t generation, Issue and Consumption.
- o Whether change in procurement cost of packing items are accumulated for impact analysis and examine the possibility of pass on to consumer.
- o Whether any abnormal cost is identified for appropriate treatment?

## 16. Audit of sales value

- o Whether Product portfolio/Product Basket considered entirely to arrive at sales value?
- o Whether increase/decrease in volume of the Product portfolio impacting sales value?
- o Whether market price movement, discount structure etc. attributing to sales revenue fluctuation?
- o Whether product-wise contribution is analysed to improve sales performance?

- o Whether new launches, change in product portfolio results in higher sales volume/value?
- o Whether higher sales value achievement is at the cost of higher Sales and Distribution expenses/expenditure?
- o Whether appropriate cut-off being observed to determine sales value for the relevant period?
- o Whether sales return and defective supplies are netted off for the purpose of sales value declaration?
- o Whether sales value trend is considered for equivalent periods of different accounting periods?
- o Whether sales budget is realistically set for comparison with actual achieved?
- o Whether analysis along-with root cause carried out to observe sale value variance on Y-O-Y basis?

## Topic

Module 8:  
Government  
Accounting in India

FINAL

Group IV - Paper-18

Corporate Financial  
Reporting (CFR)

## Topic: Government Accounting

### • Multiple Choice Questions

1. Government Accounting is primarily concerned with:

- A. Determining profitability of government departments
- B. Recording and reporting utilization of public funds
- C. Maximizing shareholder wealth
- D. Measuring market capitalization

**Answer:** B, Recording and reporting utilization of public funds

2. Government Accounting is also referred to as:

- A. Corporate Accounting
- B. Public Finance Accounting
- C. Cost Accounting
- D. Management Accounting

**Answer:** B, Public Finance Accounting

3. Which of the following is NOT a feature of Government Accounting?

- A. Fund-based accounting
- B. Double-entry system
- C. Profit maximization objective
- D. Budgetary regulation

**Answer:** C, Profit maximization objective

4. Government accounting in India is generally maintained on:

- A. Accrual basis
- B. Modified cash basis
- C. Cash basis
- D. Hybrid basis

**Answer:** C, Cash basis

5. The annual accounts of Central and State Governments cover the period:

- A. January to December
- B. July to June
- C. April to March
- D. October to September

**Answer:** C, April to March

6. Which of the following is NOT one of the three parts of Government Accounts?

- A. Consolidated Fund
- B. Contingency Fund
- C. Public Account
- D. General Reserve Fund

**Answer:** D, General Reserve Fund

7. The Consolidated Fund of India is constituted under:

- A. Article 265
- B. Article 266(1)
- C. Article 267
- D. Article 280

**Answer:** B, Article 266(1)

8. No amount can be withdrawn from the Consolidated Fund of India without:

- A. Approval of RBI
- B. Approval of C&AG
- C. Authorization by Parliament
- D. Approval of Finance Commission

**Answer:** C, Authorization by Parliament

9. The Contingency Fund of India is constituted under:

- A. Article 266(1)
- B. Article 266(2)
- C. Article 267
- D. Article 280

**Answer:** C, Article 267

10. The apex accounting body in the Government of India is:

- A. Finance Commission
- B. Comptroller and Auditor General
- C. Controller General of Accounts
- D. Public Accounts Committee

**Answer:** C, Controller General of Accounts

11. Which of the following is a primary responsibility of the Controller General of Accounts (CGA)?

- A. Conducting elections
- B. Consolidating monthly accounts of the Government of India

- C. Levying taxes
- D. Framing the Union Budget

**Answer:** B, Consolidating monthly accounts of the Government of India

12. Government Accounting Standards Advisory Board (GASAB) was constituted in:

- A. 1991
- B. 1998
- C. 2002
- D. 2013

**Answer:** C, 2002

13. GASAB was constituted by:

- A. Ministry of Finance
- B. Reserve Bank of India
- C. Comptroller and Auditor General of India
- D. NITI Aayog

**Answer:** C, Comptroller and Auditor General of India

14. The standards being developed for accrual-based accounting in Government are called:

- A. IGAS
- B. IGFRS
- C. IFRS-G
- D. IPSAS

**Answer:** B, IGFRS

15. IFRS 1 deals with:

- A. Inventories
- B. Property, Plant and Equipment
- C. Presentation of Financial Statements
- D. Revenue from Government Exchange Transactions

**Answer:** C, Presentation of Financial Statements

## • Comprehensive Questions and Answers

### 1. Discuss the role of the Public Accounts Committee in Government Accounting.

#### Role of the Public Accounts Committee (PAC) in Government Accounting

The Public Accounts Committee (PAC) is one of the most important financial committees of the Indian Parliament. It acts as a watchdog over public expenditure and helps ensure accountability in the use of public funds. The

Committee examines whether government revenues and expenditures have been managed in accordance with the authority granted by Parliament and whether public money has been utilized efficiently and for the intended purposes.

The PAC functions as an instrument through which Parliament exercises control over the financial activities of the executive. While the Comptroller and Auditor General (C&AG) independently audits government accounts, the PAC scrutinizes the audit findings and seeks explanations from the concerned ministries and departments. In this way, the PAC transforms audit observations into legislative oversight and accountability.

#### a. Examination of C&AG Reports

One of the primary responsibilities of the PAC is to examine the audit reports submitted by the Comptroller and Auditor General of India after they are presented before Parliament. During its examination, the Committee studies audit observations, identifies deficiencies in financial management, and calls upon officials to explain irregularities. The C&AG assists the Committee by providing technical and audit-related clarifications.

#### b. Scrutiny of Unauthorized and Excess Expenditure

The Committee verifies whether government expenditure has been incurred with proper parliamentary authorization. It examines whether ministries and departments have spent funds within the limits approved by Parliament and whether any expenditure has exceeded the sanctioned amount. Whenever instances of unauthorized spending or excess expenditure are detected, the PAC reports them to Parliament and recommends corrective measures.

#### c. Monitoring Financial Discipline in Ministries

The PAC reviews the manner in which ministries and government departments utilize public funds. It identifies cases of wasteful expenditure, avoidable losses, unproductive spending, delays in project implementation, and weaknesses in financial administration. Although the Committee does not question the policy decisions of the Government, it critically examines whether those policies have been implemented economically and efficiently from a financial perspective.

#### d. Examination of Audit Reports of Public Sector Undertakings and Public Corporations

Over time, the responsibilities of the PAC have expanded beyond traditional government departments. The Committee also scrutinizes audit reports relating to public corporations and government-controlled entities. Through this examination, it evaluates whether public sector organizations are functioning responsibly and whether public resources entrusted to them are being utilized effectively.

### e. Review of Administrative Efficiency

The PAC is not merely a financial control mechanism; it also contributes to administrative improvement. While examining accounts and audit reports, it gains insights into the functioning of ministries, departments, and public corporations. The Committee highlights procedural weaknesses, deficiencies in internal controls, and shortcomings in governance. Its observations often lead to improvements in administrative practices and financial management systems.

#### • Briefly discuss the features of the Government Accounting of India.

#### Answer: Features of Government Accounting in India

Government accounting in India is a specialized system designed to ensure transparency, accountability, and control over public finances. Unlike commercial accounting, which focuses on profitability, government accounting is concerned with the collection, custody, and utilization of public funds for achieving socio-economic objectives and public welfare. The major features of government accounting are discussed below.

#### 1. Accountability for Public Funds

The primary objective of government accounting is to ensure accountability in the use of public money. It records how revenues collected through taxes, duties, grants, and borrowings are utilized for various governmental activities and development programmes.

#### 2. Budget-Oriented Accounting System

Government accounting is closely linked with the budget. All receipts and expenditures are recorded under prescribed budget heads, and spending can be undertaken only within the limits approved by the legislature. This helps maintain fiscal discipline and control over public expenditure.

#### 3. Cash Basis of Accounting

A distinctive feature of government accounting in India is the use of the cash basis of accounting. Transactions are recognized only when cash is actually received or paid. Consequently, government accounts reflect actual cash inflows and outflows during the financial year.

### 4. Fund-Based Accounting Structure

Government finances are maintained through separate constitutional funds, namely the Consolidated Fund, the Contingency Fund, and the Public Account. This segregation ensures proper monitoring and utilization of public resources for their designated purposes.

### 5. Detailed Classification of Transactions

Government accounting follows a comprehensive classification system under which receipts and expenditures are grouped into sectors, major heads, minor heads, and detailed heads. This facilitates effective financial reporting, control, and analysis.

### 6. Legal and Constitutional Compliance

All government financial transactions are governed by constitutional provisions, financial rules, treasury regulations, and administrative instructions. This ensures legality, uniformity, and consistency in financial administration.

### 7. Audit and Legislative Oversight

Government accounts are subject to audit by the Comptroller and Auditor General (C&AG). The audit reports are further examined by parliamentary committees such as the Public Accounts Committee (PAC), thereby strengthening transparency and accountability in public financial management.

### 8. Welfare-Oriented Approach

Unlike business entities, governments do not operate with the objective of earning profits. Government accounting therefore focuses on ensuring that public resources are utilized efficiently for governance, development, and social welfare.

Government accounting in India is characterized by accountability, budgetary control, cash-based recording, fund-wise management, legal compliance, and rigorous audit scrutiny. These features collectively promote transparency, fiscal discipline, and responsible management of public resources, thereby supporting effective governance and public welfare.

## Topic

Module 18:  
Valuation and  
Related Party  
Transactions

FINAL

Group IV - Paper-19

Indirect Tax Laws  
and Practice (ITLP)

## Customs Valuation Rules

Constitutionally, Entry No. 83 of List I (Union List) to Schedule VII empowers the Central Government to legislate and collect duties on imports and exports. In execution, sec. 12 of the Customs Act, 1962, serves as the vital charging section, mandating the levy of duties on goods entering or leaving India. The classification of these goods and their corresponding tariff rates are governed by the Customs Tariff Act, 1975, where the First Schedule details import categories under the internationally recognized *Harmonized System of Commodity Classification (HSN)*, and the Second Schedule regulates export duties.

Because customs duties are predominantly calculated on an *ad valorem* basis (a percentage of the value of the goods), establishing a legally robust taxable value u/s 14 is the cornerstone of customs compliance and revenue integrity.

In an era of rapidly evolving global commerce, understanding the nuances of customs valuation is paramount. This document delves into the multifaceted methods—ranging from transaction value to computed and residual methods—that underpin the current valuation framework. By systematically delineating each method and its corresponding conditions, the discussion illuminates how these rules help bridge historical customs practices with contemporary standards, thereby ensuring a consistent and just approach to duty assessment and revenue collection. These rules not only ensure equitable taxation but also uphold transparency and fairness in international trade by adhering to globally recognized principles.

### Valuation on the basis of Transaction Value [Sec. 14(1)]

Under section 14(1), the value of imported goods is determined based on their **Transaction Value**, defined as the price actually paid or payable for the goods when sold for export to India, provided the following criteria are satisfied concurrently:

- The goods are meant for delivery at the time and place of importation.
- The sale occurs in the ordinary course of trade under fully competitive conditions.
- The buyer and seller are not related persons.
- Price is the sole consideration for the sale.

The transaction value will be set aside if *any* of the following conditions under Rule 3 are violated:

1. **Restrictions on Disposition:** There must be no restrictions on the buyer regarding the disposition or use of the goods, *except* those imposed by Indian public authorities, those limiting geographical resale

areas, or those that do not substantially affect the value.

2. **Unascertainable Consideration:** The sale or price must not be subject to conditions or considerations for which a value cannot be determined.
3. **Subsequent Reversion:** No part of the proceeds from subsequent resale or disposal by the buyer can accrue to the seller, unless an appropriate adjustment can be made under Rule 10.

### Taxpoint

To arrive at the final Assessable Value, the transaction value *must* include mandatory additions for costs/services not already included in the invoice price

- commissions and brokerage (excluding buying commission);
- engineering, design work;
- royalties and licence fees;
- costs of transportation to the place of importation;
- insurance;
- loading charges [Unloading and handling charges incurred *at the place of importation* (old landing charges) are nil and must not be added.]

to the extent and in the manner specified in the Customs Valuation (Determination of Value of Imported Goods) Rules, 2007

### Customs Valuation (Determination of price of imported goods) Rules

Methods to be followed (in hierarchal order) for determination of the price of imported goods

SN	Valuation Method	Key Conditions/Notes
1	<b>Transaction Value (Rule 3)</b>	<ul style="list-style-type: none"> <li>- Sale in the ordinary course of trade under competitive conditions</li> <li>- Price is the sole consideration</li> <li>- Buyer and seller are not related</li> </ul>
2	<b>Transaction Value of Identical Goods (Rule 4)</b>	<ul style="list-style-type: none"> <li>- Based on sale of goods identical in characteristics, quality, and reputation</li> <li>- Adjustments if the sale differs in quantity or commercial level</li> </ul>

SN	Valuation Method	Key Conditions/Notes
3	<b>Transaction Value of Similar Goods (Rule 5)</b>	<ul style="list-style-type: none"> <li>- Goods not identical but perform the same function</li> <li>- Similar in characteristics and component materials</li> </ul>
4	<b>Deductive Value (Rule 7)</b>	<ul style="list-style-type: none"> <li>- Based on unit price in India after deducting costs (commission, transport, insurance, taxes, etc.)</li> <li>- Applicable when preceding methods fail</li> </ul>
5	<b>Computed Value (Rule 8)</b>	<ul style="list-style-type: none"> <li>- Considers cost of materials, fabrication, processing, plus an amount for profit and general expenses</li> </ul>
6	<b>Residual Method (Rule 9)</b>	<ul style="list-style-type: none"> <li>- Applied using reasonable means with available data when none of the above methods yield a value</li> </ul>

**Note:** On request, the order of application of rules 7 (i.e. Deductive value) and 8 (i.e. Computed value) shall be reversed.

### Transaction Value [Rule 3]

Transaction value shall be accepted as price, provided the following conditions are satisfied –

1. The sale is in the ordinary course of trade under fully competitive conditions;
2. There are no restriction as to the disposition or use of the goods by the buyer other than restrictions which –
  - a. are imposed or required by law or by public authorities in India; or
  - b. limit the geographical area in which the goods may be resold; or
  - c. do not substantially affect the value of the goods;
3. The sale or price is not subject to condition or consideration for which a value cannot be determined;
4. Any part of the proceeds of subsequent resale, disposal or use of the goods by the buyer will not be shared with the seller unless an appropriate adjustment is made;
5. The buyer and seller are not related.

### Transaction value of identical goods [Rule 4]

The value of imported goods shall be the transaction value of identical goods sold for export to India and imported at or about the same time as the goods being valued.

#### Taxpoint

1. *Identical goods* means imported goods –
  - a) which are same in all respects, including physical characteristics, quality and reputation as the goods being valued except for minor differences in appearance that do not affect the value of goods;
  - b) produced in the country in which the goods being valued were produced; and
  - c) produced by the same person who produced the goods or where no such goods are available, then goods produced by a different manufacturer.

However, identical goods do not include goods where engineering, development, art work, design work, plan or sketch was done by the buyer in India free of charge or at a reduced cost.
2. Such identical goods shall be sold at the same commercial and quantity level. Where no such sale is found, the transaction value of identical goods sold at a different commercial level or in different quantity or both shall be used with certain adjustment.
3. Where more than one transaction value of identical goods is found, then the lowest of such value shall be used for determining the value of imported goods.

### Transaction value of similar goods [Rule 5]

The value of imported goods shall be the transaction value of similar goods sold for export to India and imported at or about the same time as the goods being valued.

#### Notes

1. *Similar goods* means imported goods –
  - a) which although not alike in all respect, have like characteristics and like component materials which enable them to perform the same function. Such goods shall be commercially interchangeable with the goods being valued having regard to the quality, reputation and the existence of trade-mark.
  - b) produced in the country in which the goods being valued were produced; and
  - c) produced by the same person who produced the goods or where no such goods are available, then goods produced by a different manufacturer.

However, similar goods do not include goods where engineering, development, art work, design work,

plan or sketch was done by the buyer in India free of charge or at a reduced cost.

2. Such similar goods shall be sold at the same commercial and quantity level. Where no such sale is found, the transaction value of similar goods sold at a different commercial level or in different quantity or both shall be used with certain adjustment.
3. Where more than one transaction value of similar goods is found, then the lowest of such value shall be used for determining the value of imported goods.

#### **Deductive Value [Rule 7]**

Where the goods being valued or identical or similar imported goods are sold in India at or about the time of determination of value, then the value of imported goods shall be based on the unit price at which such goods are sold in the *greatest aggregate quantity to the unrelated person in India as reduced by -*

- a) the commission usually paid or payable or the additions usually made for profits and general expenses for sales in India;
- b) the cost of transport and insurance and other cost incurred within India;
- c) the customs duty and other taxes payable in India by reason of importation or sale of the goods.

#### **Notes**

1. Where such goods are not sold at or about the same time of importation of the goods being valued, then the value of imported goods shall be based on the unit price at which the imported goods or identical or similar imported goods are sold in India at the earliest date after importation but before the expiry of 90 days after such importation.

2. Where such goods are sold in India after further processing, then the value shall be based on the unit price at which the imported goods after processing are sold in the greatest aggregate quantity to an unrelated person in India as reduced by processing and other cost (as referred above) incurred in India.

#### **Computed value [Rule 8]**

The value of imported goods shall consist of –

- a) The cost or value of materials and fabrication or other processing employed in producing the imported goods;
- b) An amount for general expenses and profit made by producers in the country of exportation for export to India;
- c) The cost of transport, insurance, etc.

#### **Residual method [Rule 9]**

Where the value of imported goods shall not be determined as per any preceding rules, then the value shall be determined using -

- reasonable means consistent with the principles;
- general provisions of these rules; and
- data available in India.

The Customs Valuation (Determination of Value of Imported Goods) Rules, 2007, provide a highly structured, objective statutory framework that anchors tax assessments firmly in authentic commercial transactions. For CMA Final candidates and practicing consultants, a rule-by-rule mastery of this hierarchy is indispensable for mitigating valuation disputes, steering clients through departmental rejections, and ensuring compliance with transfer pricing regulations in related-party trade.

## Topic

Module 4:  
Enterprise Risk  
Management

Module 9:  
Valuation in  
Mergers and  
Acquisitions

## ELECTIVES

### Paper-20A

Strategic  
Performance  
Management and  
Business  
Valuation (SPMBV)

## Enterprise Risk Management

An ERM framework is a systematic approach organization adopts to identify, assess and manage risks across the entire company to achieve its goals & objectives. Thus, it is a set of principles and procedures for effectively managing & monitoring various functional risks to achieve long term organizational objectives by continuously focusing on risk avoidance, risk reduction, risk distribution and risk acceptance.

Key components of an ERM includes identifying potential risks, risk assessment & analysis, risk governance, risk monitoring and risk reporting.

Let us briefly discuss the key focus of an ERM –

- a. It identifies risks across internal & external environments, circumstances, stakeholders and systems.
- b. Drives risk management processes throughout the organization.
- c. Gives division level managers the flexibility to implement the applicable processes while ensuring that they align with the overall risk management strategy of the enterprise.
- d. Integrates risk prevention and mitigation activities to address all areas of organisational exposure to risk (e.g., compliance, financial, governance, operational, reputational, and strategic). In essence, it takes a comprehensive, integrated and holistic view of all pertinent risks that are identified.
- e. Ensures risk management as a competitive advantage

In the aforesaid context, organisation with effective ERM, pay attention to the following important areas & tasks –

1. Organisation structure.
2. Procedures, Processes and Protocols
3. Employee education & Training
4. Monitoring, Measuring and Reporting performances.
5. Setting criteria for acceptance or tolerance of specific risks
6. Setting criteria for avoidance or termination of specific risks
7. Setting criteria for reduction or mitigation of specific risks
8. Setting policies for transferor and sharing of specific risks

The major elements constituting an ERM are-

1. Internal Environment:  
Establishing the tone for risk management by including governance, ethical values and a risk-conscious culture in the organization.

Following questions are asked –

- (a) What are the main components or drivers of the organization's strategy?
- (b) What internal or external factors or events could obstruct or disrupt the steps for executing this strategy?
- (c) Do existing systems and processes support achieving the stated goals and managing the consequent internal and external risks?

### 2. Objective Setting:

Linking risk management initiatives to overall organizational strategy by defining specific goals. To ensure that the organisational objectives are aligned with the organization's risk threshold.

### 3. Risk identification and Risk Assessment:

It is the process of identifying potential events that could affect the organization and further assessing their potential impact and likelihood on the organisation's performance. Risk assessment is usually done through a process of Risk Mapping where all the relevant risk elements are listed and each single risk element is examined as to their probability or likelihood of occurrence and possible consequence or impact.

### 4. Risk Analysis:

After identifying and assessing all possible risks, it is important to analyse the level of each category of risk which involves the examination of the likelihood and consequence of each risk factor in a given situation. The analysis may be carried out by suitable qualitative, quantitative, or semi quantitative methods, depending upon the type of risk element in a given situation.

### 5. Risk categorization and strategy:

Establishing the amount of risk an organization is willing to accept to achieve its goals & objectives depends on its risk bearing capacity. Efforts are made to categorize potential events & circumstances signifying high risk, medium risk and low risk so that proper attention towards reduction, mitigation, avoidance or sharing of the risks in each category can be given depending upon the risk bearing capacity of the organization.

### 6. Risk response:

Developing and implementing strategies to manage identified risks, which include risk avoidance, risk acceptance, risk mitigation and risk sharing.

7. Control activities:  
Implements policies and procedures to ensure the risk responses are carried out effectively. To establish suitable detective and preventive control process to identify and prevent situations that requires control.
8. Information & Communication:  
Ensures relevant risk information is captured and communicated to the stakeholders and for this purpose, meaningful reports are generated.
9. Governance & Oversight:  
Provides a structure for governance and board level oversight of risk management activities in the organization.
10. Monitoring & Review:  
Continuously evaluates the effectiveness of the risk management process and to make necessary adjustments, as needed.

#### Common frameworks –

1. COSO – The committee of Sponsoring Organizations Treadway Commission is a widely used ERM framework with eight components.
2. Other Models – Other models exist, sometimes with different number of components or steps but they generally cover the same core principles.
3. Industry specific Frameworks – Many highly regulated industries, such as financial services, healthcare and energy related entities have specific ERM frameworks or guidelines which they need to follow.

#### Implementing ERM – The steps:

1. To define the enterprise risk philosophy (ERP)
2. To establish a risk strategy & action plans that align with the enterprise risk philosophy.
3. To be clear and transparent about risk related priorities and proper communication of the same amongst the employees at various levels
4. To assign specific responsibilities for executing ERM plans – establishing Responsibility Accounting in respect of key responsibility areas.
5. To maintain flexibility & agility to respond quickly to new evolving risks
6. To continually monitor identified risks and their possible impact
7. To carefully review all perceived indicators related to future potential risks after establishing KRIs (Key Risk Indicators). The KRIs provide useful insights about potential risks and act as a catalyst for timely decision making.

8. To measure ERM program results against relevant KPIs (Key Performance Indicators) and CSFs (Critical Success Factors) at stated intervals to ensure the ERM process is delivering results in a satisfactory manner.

#### Types of Risks addressed by ERM –

1. Compliance Risks, both general compliance and specific compliance.
2. Financial Risks
3. Health & Safety Risks
4. Legal Risks
5. Operational Risks
6. Reputational Risks
7. Security Risks
8. Strategic Risks
9. Market risks

#### Potential ERM challenges –

1. As a process, ERM lacks connection between risk and return as rigorous risk mitigation efforts across key functions in an organisation may sometime impact profitability or ROI.
2. Enterprise risk management programs are guided by familiar risks. Future and unfamiliar risks are not considered seriously in the regular Risk Mitigation strategy rendering ERM process weak.
3. Enterprise risk management programs are resource-intensive. Lack of proper management time, attention, focus and understanding undermines the effectiveness of Risk Management process.
4. Enterprise risk management program depends on management forecast. Incorrect forecast based on unreliable data & information undermines the effectiveness of an ERM.
5. Enterprise risk management system often lacks visibility as certain risks are hard to detect as they overlap.
6. ERM tends to focus more on internal risks. Important external risks like market trends, competition, possible change in certain Govt. regulations, etc. are not always focused deeply rendering ERM loose its effectiveness from a long-term standpoint.
7. Risks impact various segments of an enterprise not in the same manner. Hence, their evaluation, mitigation or monitoring using some common yardstick or similar parameters or criteria becomes difficult. This again undermines the long-term effectiveness of an ERM.

**Benefits of ERM-**

1. Ability to respond quickly and effectively to any adverse business situation
2. Awareness of important risks that the entity may face
3. Efficient allocation of resources on a continuous basis
4. Enhanced overall protection of enterprise resources including human resources
5. Improved compliance environment
6. Increased efficiency and effectiveness of operations & activities.

**Concluding Remarks-**

An ERM framework is a structured approach to identify,

assess, manage, monitor and control risks across the entire enterprise to enable it achieve its strategic goals. It provides the principles and process for managing risks in a consistent and integrated manner, rather than having each department or responsibility centre manage them separately. This helps in making informed decisions, mitigating potential loss and taking advantage of opportunities.

Following such steps as risk identification, risk analysis, risk prioritisation, developing risk response & risk sharing strategies, implementation of suitable control and mitigation measures, monitoring and detecting emerging risks, and finally reviewing the entire process at regular intervals for necessary modifications or improvement, a successful and sustainable ERM process may be adopted by an organisation.

## Valuation in Merger & Acquisitions

M&A valuation is the process of determining a company's worth for a merger or acquisition and it is crucial for setting fair prices, negotiating deals and making informed decisions. It involves using a combination of methods, namely, market-based, income-based and asset-based approaches to analyse a target company's financial performance, assets & liabilities and future potential & prospects.

A valuation process in M&A indicates a fair purchase price, helps identify potential synergies, ensures regulatory compliance and protects shareholders' interest. M&A activities are normally financed through a combination of debt, cash and stock.

A merger takes place when two or more companies come together and form a new company, whilst when one company takes over another company and declares itself as the new owner, it is known as acquisition. An acquisition can be friendly or hostile.

An acquisition is usually carried out to increase the growth of an entity at a much faster rate and to take advantage of the existing internal and external economies of the acquired business entity. Mergers are carried out to increase market share, strengthen R&D and innovation initiatives, facilitate diversification & expansion, acquire assets, enhance financial capabilities & operating efficiencies and take major tax benefits.

**Importance of Valuation in M&A:****Negotiation & Pricing -**

For providing a basis for negotiation by establishing a fair price for the target company, thus, preventing overpayment by the buyer and ensuring a fair return for the seller. This helps to determine the share exchange ratio between the transferor and the transferee companies on a reasonably correct basis.

**Informed Decision making –**

It gives the acquirer a clear understanding of the target company 's financial health, market position and potential synergies to help make an informed decision about the deal.

**Regulatory Compliance –**

Regulatory bodies often require detailed valuation report before approving schemes of M&A.

**Strategic Alignment –**

It helps to ensure that the deal aligns with the strategic goals of both the companies (transferor & transferee) and provides a basis for fairness and acceptability to protect the shareholders' interest.

**Synergy Assessment –**

It helps to evaluate how two companies can be worth more together by analysing cost savings, revenue opportunities and operational efficiencies.

**Laws in India impacting M&A Valuation –**

- Companies Act, 2013
- FEMA, 1999
- SEBI Guidelines and Stock Exchanges Rules
- Provisions of The Competition Act
- Stamp Act/Stamp Duty provisions
- Income Tax provisions
- Provisions relating to certain Indirect Taxes
- Accounting Standards.

**Valuation Approaches in M&A –**

Major Approaches are -

### 1. Market Approach-

It compares the company to similar publicly traded companies or recent comparable transactions to establish a relative value. A minority interest market value is provided in the market approach

### 2. Income Approach-

This approach values the company based on its ability to generate future income under DCF method. The method analyses future cash flows and discounts them back to their present value.

### 3. Asset- based Approach–

This approach focuses on the net value of the Company's underlying assets which can be the sum of its tangible and intangible assets. The net asset value is determined by subtracting total liabilities from total assets. The approach is employed for valuations in going concern entities as well as for companies in liquidation.

### Methods of Valuation in M&A –

Based on the above-mentioned approaches, following valuation methods may be stated -

#### 1. Net Asset Method –

This method comes under the asset-based approach.

It determines the fair market value of every asset and liability on the date of valuation. In this method, the equity value is estimated based on adjusted assets minus the adjusted liabilities. Usually, the underperforming assets are considered by the acquiring company thru this method.

#### 2. Excess Earnings Treasury Method-

This method considers the concept of both asset-based and income-based approaches.

It differentiates among intangible assets and adjusted net tangible assets. The estimation of intangible value is done by capitalizing those earnings of the company that are more than the earnings related to a reasonable return on the fair market value of its net assets. The total value of the Company is calculated by combining the tangible net adjusted assets at fair market value with the intangible value as estimated. This method makes use of the average return on equity from similar companies or industry averages to estimate a reasonable return while determining the right capitalization rate.

#### 3. Excess Earnings Reasonable Rate Method-

This method considers both asset-based and income-based approaches.

In this method, a reasonable rate of return is applied

to the adjusted net assets. The estimation of intangible value is done by capitalising those earnings of the company that are more than the earnings relating to a reasonable return on the fair market value of its net assets. To estimate the total value of the company, the intangible value is combined with the fair market value of the adjusted net assets.

#### 4. Capitalization of Earnings Method –

This method comes under income-based approach.

This method is used to determine the value of a profitable company when the investor aims to facilitate an annual rate of return on investment over reasonable compensation of the owner. The future estimated earnings are determined and divided by a capitalization rate to obtain a value. In this method no separation is made between the tangible and intangible assets. This method is not appropriate for capital intensive companies.

#### 5. Discounted Cash Flow Method (DCF) –

This method comes under income-based approach.

This method is also known as Discounted Earning Method (DEM). In this method, to determine the value of a company, its earnings are defined which may be post tax cash flow and cash flow from operations. The assumption in this method is that the total value of the company is estimated by determining the current value of the projected future earnings and the current value of the terminal value by using a suitable capitalisation rate. The valuer in this method must be satisfied that the projected earnings are backed by the assumptions of the management and constitute reasonable future earnings.

#### 6. Price Earnings Ratio Method –

This method is a combination of both income-based and market-based approaches.

In this method, market comparison is used to estimate the multiple to be applied against post tax earnings. A weighted average price earning ratio of similar publicly traded companies help in capitalizing the future estimated net income (post tax). The main problem in making market comparisons is finding publicly traded companies that are similar to the target company. This method is generally used to determine the value of large and diversified companies.

#### 7. Dividend -Paying capacity Method-

This method is a combination of both income-based and market based approaches.

This method is usually employed to determine the value of large companies that pay dividends. A weighted average of dividend yields for a given

number of years of similar companies help in capitalizing the future estimated dividend to be paid. When the valuation of larger and diversified company is required, this method may be used.

#### 8. Guideline Method-

This method is based on market-based approach.

It draws a qualitative and quantitative comparison between the target company and the public companies (guideline companies) that are similar to it. The valuer must be satisfied that the public companies and the target company carry out similar functions, have similar products & services and are based in the same geographical locations. The required adjustment to the financial statements of the public companies held for comparison must be made by the valuer.

#### 9. Direct Market Data Method

This method is based on market-based approach.

It uses the sales transaction of an entity to compare with the acquisition candidate. However, it is not an easy task to compare the sales transaction as they often get consummated due to favourable purchase terms, acquired synergies, etc. Thus, the valuer is required to adjust the direct market data, if used for a premium or discount market pricing.

#### 10. Rule of Thumb Method –

This method is based on market-based approach.

It is derived from the direct market data method. A formula is determined based on industry wide experience. This formula is used to ascertain the relations between the sales price and the operational unit of measurement regarding a particular industry. This method provides an effective test to check whether the value estimates determined from other methods are reasonably correct or not.

#### Factors affecting M&A Valuation:

Major factors are -

- Collaboration & Strategic Fit – consideration of long-term strategic benefits.
- Regulatory and Legal Issues - possible impact on future profitability and business operations.

- Market and Economic conditions – competition, impact on future pricing policy.
- Tax considerations – possible tax advantages.
- Technology and Intellectual Property – consideration as to technology upgradation and protection of intellectual property rights.
- Debt and Financing Structures – debt levels and their sustainability
- Buyer Type – strategic or otherwise

**Challenges in M&A Valuation:** Major challenges are -

- a) Relevance & reliability of data quality
- b) Synergy evaluation
- c) Reliability of financial forecasts
- d) Reliability of valuation process
- e) Relevance of valuation approaches & method chosen in a given case so as to determine the correct share exchange ratio between the entities
- f) Market sensitivity to the entity's business with reference to any key or limiting factor(s)
- g) Quality & coverage of due diligence
- h) Behavioural dimension of the M&A, beyond the financial and legal framework, that impacts post merger continuity of the merged entity.

#### Concluding Observations:

M&A forms a major part of activities in the corporate sector. Due to significant level of competition in the market, many companies opt for mergers and acquisitions to take advantage of various operational synergies. The value of the target company is determined based on the purpose for which it is getting merged or acquired. The valuation is done based on income, market or asset-based approaches. These approaches further lead to selection of suitable methods of valuation which are carried out in a given context that justifies the purpose of the merger or acquisitions and protects the interest of all stakeholders under a given set of conditions & circumstances.

## Topic

Module 5:  
Operational Risk  
and Off-Balance  
Sheet Risk

Module 8:  
Managing Risk in  
Insurance Business

## ELECTIVES

Paper-20B

Risk Management  
In Banking and  
Insurance (RMBI)

## Risk Management in Banking Operational Risk and Off-Balance Sheet Risk

Risk management is a fundamental function in the banking industry, aimed at identifying, measuring, monitoring, and controlling various risks that may adversely affect a bank's financial position, operational efficiency, reputation, and long-term sustainability. The modern banking environment is characterized by increasing digitalization, globalization, complex financial instruments, and evolving regulatory requirements. As a result, banks are exposed to numerous forms of risk that require sophisticated management frameworks. Among these, operational risk and off-balance sheet risk have emerged as significant areas of concern due to their potential to generate substantial losses and threaten the stability of financial institutions.

**Sources and Causes of Operational Risk:** One of the primary sources of operational risk is human error. Employees may make mistakes while processing transactions, maintaining records, authorizing payments, or handling customer accounts. In some cases, operational losses arise from intentional misconduct such as fraud, embezzlement, unauthorized trading, or misappropriation of funds.

Another significant source is process failure. Banking operations involve numerous procedures and controls designed to ensure accuracy and compliance. Weaknesses in these processes may result in incorrect transactions, delayed settlements, documentation deficiencies, and regulatory violations.

Technology-related failures have become increasingly important in modern banking. Banks rely heavily on information systems, digital platforms, data centres, and communication networks. System outages, software defects, cybersecurity breaches, ransomware attacks, and data theft can severely disrupt banking operations and expose institutions to substantial losses.

External events also contribute to operational risk. Natural disasters such as floods, earthquakes, cyclones, and pandemics can interrupt banking activities and damage physical infrastructure. Similarly, political unrest, terrorist attacks, and economic disruptions may adversely affect banking operations.

**Operational Risk Management Framework:** An effective operational risk management framework begins with risk identification. Banks systematically identify potential risk exposures through internal audits, risk assessments, process reviews, incident reporting systems, and compliance evaluations. Risk identification helps management understand vulnerabilities across various business functions.

Following identification, risks are assessed based on their likelihood of occurrence and potential impact. Banks

often use risk matrices and scoring models to prioritize risk exposures and allocate resources accordingly.

Continuous monitoring is essential to ensure that operational risks remain within acceptable levels. Banks employ Key Risk Indicators (KRIs) to monitor trends and identify emerging issues. Examples include the number of fraud incidents, customer complaints, system downtime, cybersecurity breaches, and processing errors.

Risk mitigation involves implementing preventive and corrective measures. These measures may include strengthening internal controls, improving employee training, enhancing cybersecurity frameworks, segregating duties, establishing approval hierarchies, and developing contingency plans. Business Continuity Planning (BCP) and Disaster Recovery Planning (DRP) are integral components of operational risk management, ensuring that critical banking functions can continue during disruptions.

**Understanding Off-Balance Sheet Risk:** Off-balance sheet risk arises from financial commitments and contingent liabilities that do not appear directly on a bank's balance sheet but may create future obligations. Although these transactions may not involve immediate cash outflows, they expose banks to significant financial risks if certain events occur.

The growth of modern banking has increased the use of off-balance sheet activities as institutions seek to generate fee-based income, support customer financing requirements, and improve profitability. While these activities provide business opportunities, they also create hidden exposures that may become substantial during periods of economic stress.

**Nature of Off-Balance Sheet Exposures:** One of the most common forms of off-balance sheet exposure is bank guarantees. A guarantee represents a commitment by the bank to make payment if the customer fails to fulfil contractual obligations. While guarantees do not initially affect the balance sheet, they can become actual liabilities if the borrower defaults.

Letters of credit are another significant off-balance sheet instrument. Widely used in domestic and international trade, letters of credit assure sellers that payment will be made upon compliance with specified conditions. The issuing bank assumes a contingent obligation that may crystallize under certain circumstances.

Loan commitments also constitute off-balance sheet exposures. Banks frequently provide sanctioned credit facilities that customers may draw upon in the future. Although these commitments are not immediately reflected as assets, they can create liquidity and credit risks when utilized.

Derivative contracts represent a major category of off-balance sheet activities. Instruments such as interest rate swaps, currency swaps, options, futures, and forward contracts are used for hedging and trading purposes. While derivatives may not require substantial initial investment, they can expose banks to market volatility and counterparty defaults.

**To Conclude**, Operational risk and off-balance sheet risk have become increasingly significant in the modern banking environment. While operational risk arises

from failures in people, processes, systems, and external events, off-balance sheet risk originates from contingent liabilities and commitments that may create future obligations. Effective management of these risks requires strong governance, robust internal controls, advanced technological systems, regulatory compliance, and continuous monitoring. Banks that successfully manage these risks are better positioned to maintain financial stability, protect stakeholder interests, and support sustainable growth.

## Risk Management in Insurance Managing Risk in Insurance Business

Risk management lies at the heart of the insurance industry. Unlike most businesses that seek to avoid risk, insurance companies exist to assume, evaluate, and manage risks on behalf of policyholders. The primary objective of an insurer is to provide financial protection against uncertain future events while maintaining sufficient profitability and solvency.

The insurance business operates in an environment characterized by uncertainty. Insurers face risks arising from underwriting activities, investment operations, market fluctuations, catastrophic events, and changing regulatory requirements. Consequently, effective risk management is essential to ensure that insurance companies can meet their contractual obligations to policyholders while achieving sustainable financial performance.

**Nature and Importance of Risk Management in Insurance:** The insurance business is fundamentally based on the principle of risk pooling, whereby premiums collected from a large number of policyholders are used to compensate those who suffer losses. The success of this model depends on the insurer's ability to accurately estimate future claims and maintain adequate financial resources.

Risk management enables insurance companies to identify potential threats, measure their impact, and implement appropriate mitigation strategies. It supports prudent decision-making, protects policyholder interests, enhances financial stability, and strengthens public confidence in the insurance sector.

As insurance companies increasingly operate in a complex global environment, risk management has evolved from a traditional actuarial function to an enterprise-wide strategic discipline.

**Underwriting Risk:** Underwriting risk is one of the most significant risks faced by insurance companies. It arises when actual claims exceed anticipated claims due to inaccurate risk assessment, improper pricing, or unforeseen developments.

The underwriting process involves evaluating applicants, assessing the likelihood of future losses, and determining appropriate premium rates. If risks are underestimated or premiums are inadequately priced, the insurer may experience higher claim payouts than expected.

Various factors contribute to underwriting risk, including changes in mortality rates, morbidity patterns, accident frequencies, medical inflation, legal developments, and economic conditions. Effective underwriting practices are therefore essential for maintaining profitability and solvency.

**Catastrophe Risk:** Catastrophe risk represents one of the most challenging risks for insurance companies. Natural disasters such as earthquakes, floods, hurricanes, cyclones, and wildfires can generate enormous losses affecting thousands of policyholders simultaneously.

The frequency and severity of catastrophic events have increased due to climate change, urbanization, and environmental degradation. Insurers employ sophisticated catastrophe modelling techniques to estimate potential losses and determine appropriate risk transfer strategies.

**Reinsurance as a Risk Management Tool:** Reinsurance is one of the most important mechanisms available to insurance companies for managing risk. Through reinsurance, an insurer transfers part of its risk exposure to another insurance company in exchange for a portion of the premium.

This arrangement enhances the insurer's capacity to underwrite larger risks, stabilizes earnings, protects against catastrophic losses, and reduces capital strain. Reinsurance also supports solvency by limiting the financial impact of unusually large claims or catastrophic events.

Both proportional and non-proportional reinsurance arrangements are widely used depending on the nature of the risks being transferred and the objectives of the insurer.

**Emerging Risks in the Insurance Industry:** The insurance industry faces several emerging risks that require continuous monitoring and adaptation. Cyber risks have become increasingly important as digitalization expands. Data breaches, ransomware attacks, and cyber fraud can result in significant financial and reputational consequences.

Climate change is creating new challenges through more frequent and severe natural disasters. Insurers must continuously reassess underwriting models and catastrophe assumptions to address evolving environmental risks.

Pandemics, geopolitical uncertainties, technological disruptions, and artificial intelligence-related risks are

also reshaping the insurance landscape. Successful insurers must remain agile and proactive in identifying and managing these emerging threats.

**To Conclude,** Risk management is the cornerstone of the insurance business and serves as the foundation for financial stability, policyholder protection, and sustainable growth. Through effective underwriting, investment management, reinsurance strategies, liquidity planning, operational controls, and enterprise risk management frameworks, insurers can successfully navigate an increasingly complex risk environment. As the nature of risk continues to evolve, insurance companies must strengthen their risk management capabilities to ensure resilience, competitiveness, and long-term success.

## Topic

Module 5:  
Scalability, Scaling  
up and Stabilisation  
of Sustainable  
Business

## ELECTIVES

### Paper-20C

Entrepreneurship  
and Start Up (ENTS)

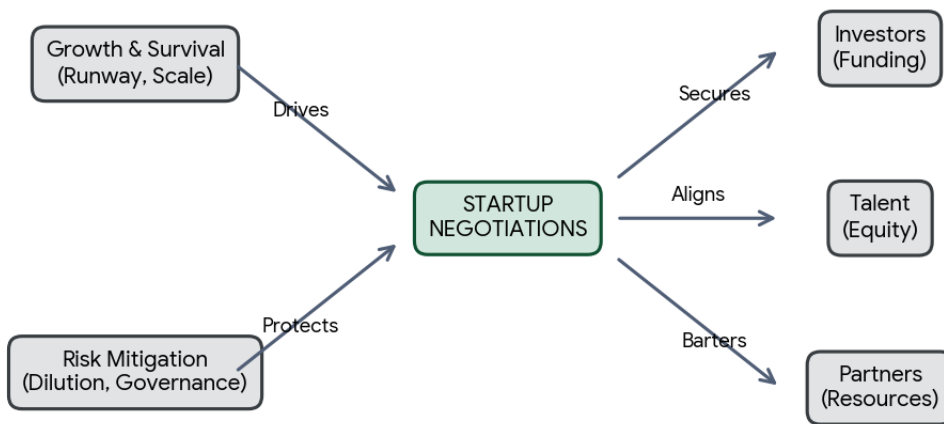
## Startups Negotiations

Startup negotiation refers to the process of discussing and reaching agreements between a startup and its stakeholders, such as investors, co-founders, employees, customers, suppliers, and strategic partners. The objective is to create mutually beneficial arrangements while protecting the startup’s interests and growth potential.

Negotiating a startup deal in India comes with a unique set of cultural nuances, complex regulatory hurdles, and distinct ecosystem behaviors. While the foundational stages of negotiation (Preparation to Closing) remain the same globally, the execution within India requires navigating specific local realities.

Startup negotiations are critical because early-stage ventures operate in an environment of extreme resource scarcity, unproven market value, and high structural risk. Unlike established corporations with deep pockets and standardized rules, a startup must use negotiation as a core tool to survive, acquire capital, attract top talent, and build operational momentum from scratch. The diagram below illustrates how startup negotiations act as the central mechanism connecting a company’s internal survival drivers with its external ecosystem.

The Ecosystem of Startup Negotiations



Source: How to Negotiate with Private Equity Firms | Windsor Drake

# Startup Milestones For Every Startup Stage

Milestone	Pre-Seed	Seed	Series A	Series B	Series C+
<b>Management</b>	Founding team assembled and roles defined	Initial team expansion and key hires	Management structure established	Executive team growth and scaling	Optimization of leadership team
<b>Product</b>	MVP development and early user feedback	Product-market fit achieved	Scaling user base	Product enhancement and scaling	Continued product optimization

Milestone	Pre-Seed	Seed	Series A	Series B	Series C+
<b>Marketing/Sales</b>	Market research and customer persona defined	Go-to-market strategy formulated	Initial customer acquisition	Sales and marketing expansion	Market dominance and expansion
<b>Strategy</b>	Business plan and initial market entry	Validation of business model	Scaling and market expansion	Strategic partnerships	Diversification and new markets
<b>Revenue</b>	Pre-revenue phase	Initial revenue generation	Revenue growth and scaling	Accelerated revenue growth	Sustained high revenue performance
<b>Regulatory</b>	Regulatory research and compliance planning	Compliance preparations	Regulatory submissions	Ongoing compliance management	Regulatory audits and reporting

Created by **Alessandro Marianantoni**

Source: [https://www.linkedin.com/posts/alessandromarianantoni\\_investing-venturecapital-strategy-activity-7131371154153361408-yD7V](https://www.linkedin.com/posts/alessandromarianantoni_investing-venturecapital-strategy-activity-7131371154153361408-yD7V)

### Principles of Successful Startup Negotiations

Following are the principles of startup negotiations:

1. Preparation of Documents: Founders will gather information about:
  - Market conditions
  - Competitors
  - Investor expectations
  - Financial projections
2. Know Your BATNA (Best Alternative to a Negotiated Agreement): Analyse Best Alternative to a Negotiated Agreement and identify the best option available if negotiations fail.
3. Focus on Value Creation: Founder seek win-win outcomes rather than merely claiming value.
4. Maintain Flexibility: Founder always be ready to explore alternative structures and terms.
5. Build Relationships: Long-term relationships are often more valuable than short-term gains. It should be analysed by the founder before negotiations.

6. Protect Core Interests: Avoid compromising on critical issues such as:

- Excessive equity dilution
- Intellectual property rights
- Strategic control

### Stages of Negotiations

The negotiation process generally passes through the following stages:

#### 1. Seed Stage Negotiations

Seed-stage negotiations refer to the discussions between founders and early-stage investors where they finalize the financial and legal terms of an investment.

#### Characteristics

- Startup is at the idea or prototype stage.
- Limited revenue or no revenue.
- High business risk.

#### Key Negotiation Points

- Initial valuation
- Amount of seed funding
- Founder equity dilution
- Use of funds
- Investor advisory role

#### Investors

- Friends and Family
- Angel Investors
- Seed Funds

#### Example

A founder seeks ₹20 lakh to develop a prototype and negotiates equity with an angel investor.

#### 2. Early-Stage (Series A) Negotiations

Series A negotiations mark a critical shift from the flexible, short-form nature of seed funding to formal, legally binding priced equity rounds using Cumulatively Compulsorily Convertible Preferred Shares (CCPS). At this stage, startups are no longer just selling an idea; they are trading equity based on a proven, repeatable revenue model and early product-market fit to scale growth. Investors look to purchase 20% to 30% of the company, making it essential for founders to strategically balance economic value with long-term operational control.

#### Characteristics

- Product has been launched.
- Initial customers have been acquired.
- Business model is being validated.

#### Key Negotiation Points

- Company valuation
- Growth strategy
- Board representation
- Founder control
- Future funding requirements

#### Investors

- Venture Capital (VC) Firms
- Institutional Investors

#### Example

A startup raising ₹5 crore negotiates a board seat for the VC investor.

#### 3. Growth Stage (Series B & C) Negotiations

Growth-stage negotiations (Series B & C) shift the focus from a startup's potential to its verifiable unit economics, operational scale, and path to liquidity. Unlike earlier seed or 'Series A' rounds where agreements rely heavily on future promises, Series B and C deals are highly data-driven and strictly negotiated via formal priced equity term sheets.

Dimension	Series B Focus	Series C Focus
Primary Goal	Scaling the machine; expanding market reach and optimizing sales team efficiency.	Market dominance; funding acquisitions, entering international markets, or preparing for an exit.
Core Metrics	Annual Recurring Revenue (ARR) growth rate, Net Revenue Retention (NRR), and Customer Acquisition Cost (CAC) efficiency.	Total EBITDA (or path to profitability), market share percentage, and multi-national regulatory compliance.
Investor Profile	Growth-stage Venture Capitalists (VCs).	Private Equity (PE) firms, hedge funds, sovereign wealth funds, and investment banks.

#### Characteristics

- Rapid revenue growth.

- (ii) Expanding customer base.
- (iii) Scaling operations.

#### Key Negotiation Points

- (i) Expansion funding
- (ii) Investor rights
- (iii) Performance milestones
- (iv) Liquidation preferences
- (v) Anti-dilution provisions

#### Investors

- (i) Large Venture Capital Firms
- (ii) Private Equity Investors

#### Example

A startup negotiating ₹50 crore funding discusses expansion into international markets.

#### 4. Late-Stage Negotiations

Late-stage startup negotiations (Series D, E, and beyond) focus primarily on structuring a viable path to liquidity (IPO or M&A), managing heavy cap table complexity, and balancing valuation against structured investor protections. Unlike early-stage rounds focused on milestones, late-stage rounds deal with massive checks from sophisticated global asset managers, crossover funds, and private equity giants.

The venture capital market behaves like a bifurcated ecosystem. The top 1% of late-stage companies (especially in sectors like AI and deep tech) command multi-billion-dollar premiums and founder-friendly terms, while the remaining 99% face rigorous scrutiny on fundamentals, slower growth, and heavy structuring to secure capital.

#### Characteristics

- (i) Established business model.
- (ii) Significant market presence.
- (iii) Preparing for exit opportunities.

#### Key Negotiation Points

- (i) Company valuation
- (ii) Strategic partnerships
- (iii) Exit rights
- (iv) Corporate governance
- (v) IPO readiness

#### Investors

- (i) Private Equity Firms
- (ii) Strategic Investors

- (iii) Sovereign Wealth Funds

#### Example

An investor negotiates rights related to a future IPO.

#### 5. Pre-IPO Negotiations

Startup IPO Negotiations refer to the discussions and agreements between a startup and various stakeholders (investment bankers, underwriters, investors, regulators, promoters, and legal advisors) before launching an Initial Public Offering (IPO). The objective is to determine the terms, pricing, structure, and conditions under which the startup's shares will be offered to the public. An IPO is the process by which a private startup becomes a publicly listed company by offering its shares to the public for the first time.

#### Characteristics

- (i) Startup is close to becoming a public company.
- (ii) Lower risk compared to earlier stages.

#### Key Negotiation Points

- (i) IPO pricing
- (ii) Shareholding structure
- (iii) Lock-in periods
- (iv) Exit mechanisms
- (v) Regulatory compliance

#### Investors

- (i) Institutional Investors
- (ii) Investment Banks

IPO negotiations consist of the following negotiations

- (a) **Valuation Negotiation:** The startup and investment bankers negotiate the company's valuation and consider Company worth, Future growth prospects, Industry comparisons and Revenue and profitability to arrive at a fair market value for the startup.
- (b) **Share Price Negotiation:** The offer price of shares is determined by analysing Demand from investors, Market conditions, financial performance and Competitor valuations to maximize capital raised while ensuring investor interest.
- (c) **Underwriting Agreement Negotiation:** Negotiations occur with merchant bankers and underwriters and will consider Underwriting commission, Risk-sharing arrangements, Number of shares underwritten to ensure successful subscription of shares.
- (d) **Equity Dilution Negotiation:** Founders negotiate the percentage of ownership they are willing to

dilute and consider Promoters' shareholding after IPO, voting rights, Control over management to raise funds without losing strategic control.

- (e) **Lock-in Period Negotiation:** Restrictions on selling shares by founders and early investors and analyse Duration of lock-in, Conditions for share sale to maintain investor confidence after listing.
- (f) **Regulatory Compliance Negotiation:** The startup works with regulators and advisors and considers Disclosure requirements, Corporate governance standards and Listing norms to obtain regulatory approval.

(g) **Allocation of Shares:** Negotiation regarding allocation among different categories of investors such as Qualified Institutional Buyers (QIBs), Retail Investors, High Net-Worth Individuals (HNIs) and Employees to achieve balanced ownership and demand.

(h) **Corporate Governance Negotiation:** Public investors expect strong governance standards and due importance will be given to Independent directors, Board structure, Audit committees, Reporting requirements to improve transparency and accountability.

### Major Issues Negotiated at All Levels

Negotiation Factor	Seed Stage	Early Stage	Growth Stage	Late Stage
Valuation	Very Important	Very Important	Important	Important
Equity Stake	High Focus	High Focus	Moderate	Moderate
Board Seats	Limited	Important	Very Important	Very Important
Voting Rights	Basic	Moderate	Significant	Significant
Liquidation Preference	Basic	Important	Very Important	Very Important
Exit Strategy	Limited	Moderate	Important	Critical
Founder Control	High Concern	High Concern	Moderate	Lower Concern

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### Submission Guidelines:

- ⦿ **Article Length:** Please prepare articles ranging between 1200 to 1500 words.
- ⦿ **Topic:** The articles can cover a wide spectrum of subjects, including but not limited to advancements in finance, industry insights, case studies, personal experiences and emerging trends in the field.
- ⦿ **Originality:** We encourage you to share your unique perspectives and experiences. Ensure that your submission has not been published elsewhere.

**Submission Deadline:** We kindly request you to submit your article by 20<sup>th</sup> of the previous month of publication. This will allow us ample time to review and prepare the upcoming issues of the CMA Student E-Bulletin.

**Submission Process:** Please send your article to [studies.ebulletin@icmai.in](mailto:studies.ebulletin@icmai.in) with the subject line "CMA Student E-Bulletin Submission - [Your Name, Registration No.]". Include a brief author bio and a high-resolution photograph to be featured alongside your article.

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Best Regards,

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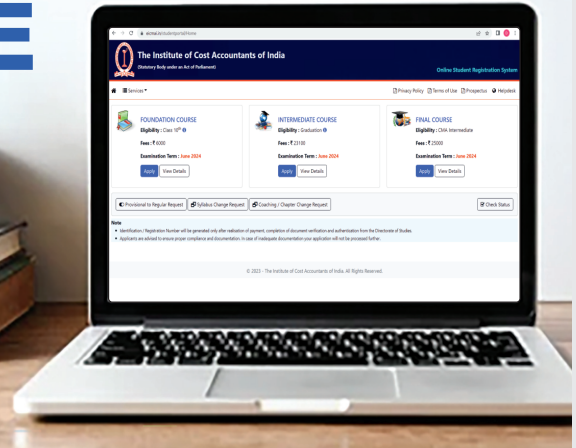


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## NEW IT INITIATIVE TO PROVIDE ENHANCED FACILITIES TO CMA STUDENTS



A login feature has been integrated into the **ONLINE REGISTRATION APPLICATION SYSTEM** enabling students to access various services through their accounts.

To utilize this feature, students need to create a login account by verifying their email address through an OTP sent to their registered email ID. Once the email ID is verified, it becomes the user ID and students can set their password during the account creation process.

The introduced system enables students to:

Register online for Foundation, Intermediate & Final Courses

Check the status of their online applications

Request Conversion from Old Syllabus to New Syllabus

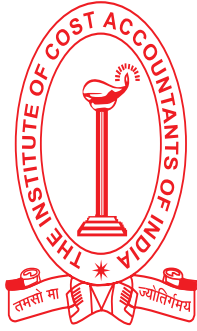
Request changes in Oral / Postal Coaching and opt for Chapter-to-Chapter Conversion

Convert from Provisional to Regular status

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Behind every successful business decision, there is always a **CMA**





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Behind every successful business decision, there is always a CMA