CMA Students Newsletter(For Intermediate Students)

Vol.3B: February 16,2014

Special Purpose Audit

1. Energy Audit

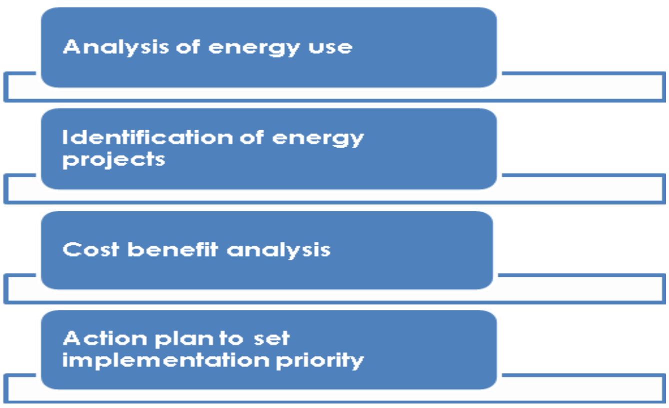
An energy audit is a preliminary activity towards instituting energy efficiency programs in an establishment. It consists of activities that seek to identify conservation opportunities preliminary to the development of an energy savings program.

To institute the correct energy efficiency programs, you have to know first which areas in your establishment unnecessarily consume too much energy, e.g. which is the most cost-effective to improve. An energy audit identifies where energy is being consumed and assesses energy saving opportunities - so you get to save money where it counts the most.

In the factory, doing an energy audit increases awareness of energy issues among plant personnel, making them more knowledgeable about proper practices that will make them more productive. An energy audit in effect gauges the energy efficiency of your plant against "best practices". When used as a "baseline" for tracking yearly progress against targets, an energy audit becomes the best first step towards saving money in the production plant.

Contents of an Audit

An energy audit seeks to document things that are sometimes ignored in the plant, such as the energy being used on site per year, which processes use the energy and the opportunities for savings. In so doing, it assesses the effectiveness of management structure for controlling energy use and implementing changes. The energy audit report establishes the needs for plant metering and monitoring, enabling the plant manager to institutionalize the practice and hence, save money for the years to come. The energy audit action plan lists the steps and sets the preliminary budget for the energy management program.



1. Analysis of energy use

Identifying where energy is used is useful because it identifies which areas the audit should focus on and raises awareness of energy use and cost. The results of the analysis can be used in the review of management structures and procedures for controlling energy use.

Analysis of energy use can be done by installing sub-meters in different plant locations to pinpoint actual energy usage per area. This is a good source data for allocating energy use. The plant manager can also list all equipment used and the corresponding operating hours. With this information, he can create spreadsheet information and generate charts useful for analysis.

Important Points to Consider When Collecting Site Load Data

a. Operating hours - This can be gathered from plant personnel. It is important to ensure the accuracy of this data because much of the potential for energy savings lies on correct estimation of the equipment's operating hours.

b. Duty cycle - Machines such as large electric motors have varying loads and hence, different power requirements.

c. Actual power consumed - For electric power users, this is based on either 3-phase current/voltage readings or power analyzer measurements (e.g., direct kW which incorporates power factor). For fuel users, tank readings of monthly consumption estimates and flow meters with totalization can be sources of measurement.

2. Identification of energy projects

Opportunities for energy savings can range from the simplest, such as lighting retrofits, to the most complex such as the installation of a co-generation plant. The important thing to remember is to focus on major energy users and areas. Always apply the 80/20 rule, focus on opportunities that provide 80% of the saving but require 20% input. After the preliminary identification of opportunities, spend more time on those which have shorter payback periods.

3. Cost benefit analysis

The identified energy conservation opportunities should be analyzed in terms of the costs of implementing the project versus the benefits that can be gained. If you want to, say, install a heat plate exchanger to recover waste heat, you need to calculate the total cost of installation and compare that with the savings you will derive from recovering waste heat. It makes sense to go on with the project if there is a net positive benefit from the project.

4. Action plan to set implementation priority

After passing the cost benefit test, an action plan should be developed to ensure that the opportunities identified are implemented. The action plan should include all the major steps for implementing the opportunity as well as the people responsible. Furthermore, there should be a plan for monitoring the results.

2. Comparison of Companies Act, 1956 and Companies Act, 2013

Basis of Comparison	Companies Act ,1956	Companies Act ,2013
1. Maximum number of members for private company	50 (Fifty)	200 (Two Hundred)
2. Minimum Number of members	Public Company - 7 Private Company - 2	No change for private and public companies. New concept of one person company introduced which can have a single member
3. Object Clause of MOA	Object clause consists of Main Objects, Incidental or Ancillary Objects and Other Objects.	MOA to contain the objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof.
4. Issue of Preference Shares for more than 20 years	Prohibited	Permitted, only for infrastructure projects
5. Maximum time for holding first AGM	18 months from incorporation or 9 months from closure of accounts, whichever is earlier	9 Months from closure of accounts
6. Mode of Notice for holding AGM	Written Notice mandatory	In writing or in electronic form.
7. Statutory Meeting	For Public company mandatory to hold after 1 month but before 6 months from the date of entitlement to commence business.	No provision
8. Maximum Number of Directors	12	15 More than 15 can also be appointed by passing special resolution at EGM
9. Certification of Financial Statements	By Manager or Secretary, if any, and by not less than 2 directors one of whom shall be the MD where there is one.	Chairman alone can sign if so authorized by the Board.

10. Cross Border Mergers	No Specific Provisions	Merger of Indian Companies with foreign companies permitted and rules to be notified by Central Government
11. Maximum Tenure of Auditors	No Specific Provisions	For listed companies and other prescribed companies: - individual auditors to be rotated after 5 years - audit firm after every 10 years
12. Service of Documents by company or an officer	By post under a certificate posting or by registered post	By registered post, speed post or courier.
13. Issue of Shares at Discount	Permitted subject to compliance with conditions	Prohibited except in case of sweat equity shares
14. Time and day for holding AGM	During business hours, on a day that is not a public holiday	During business hours i.e between 9 A.M. and 6 P.M. on any day that is not a National Holiday
15. Consent for shorter notice for holding AGM	By all members entitled to vote at the meeting	By not less than 95% of the members entitled to vote at the meeting
16. Financial Year and Extension.	Financial year not to exceed fifteen months. Financial year can end on date other than 31st March. Financial Year can be extended up to 18 months by ROC.	Financial year to end on 31st March every year for all companies. No explicit provision regarding extension of financial year is given.
17. Registered Office of New Company	Details of the Registered office to be filed in e-Form 18 at the time of incorporation.	Company shall have registered office within 15 days. Verification of registered office to be furnished within thirty days of its incorporation.
18. Notice of Change in Registered Office of Existing Company to ROC	Within 30 days of the change.	Within 15 days of the change.
19. Restrictions on Commen-cement of Business	Provision is applicable only to Public Companies	Applicable to all companies having share capital viz., Public Company, Private Company and One Person Company.
20. Alteration of Article for Conversion of company to public or private company.	Special Resolution to be filed within 30 days from the date of General meeting approving the special resolution	To be filed within 15 days

21. Procedure for Issue of share on private placement, bonus share and GDRS	No Specific Provisions	Contains specific provisions
22. Consolidation and Division of Shares	Permitted to consolidate and divide share by passing resolution in general meeting	Changes in the voting percentage of shareholders require approval of the Tribunal.
23. First Board Meeting	No specific time stipulated	Within 30 days from the date of its incorporation
24. Time Gap between two board meetings	At least one meeting to; be held in every quarter	Not more than 120 days gap between two consecutive board meetings.
25. Length of Notice for Board Meetings	No specific length of notice specified	Not less than seven days notice
26. Quorum of General Meeting for Private and Public Companies	Private - 2 Members Public - 5 Members	Private - 2 Members Public - 5 members if total no. of members < 1000 - 15 members if total no. of members > 1000 but < 5000 - 30 members if total no. of members > 5000

27. Maximum Number of Directorship	15 (Excludes private companies, unlimited companies, alternate directorship and directorship in non-profit associations)	20 (Out of which not more than 10 can be public companies and includes Alternate Directorship also)
28. Composition of Board	Public Company - 3 Private Company - 2	Public Company - 3 Private Company - 2 **Every** company to have atleast one director who has stayed for atleast 182 days in India in previous Calendar year. Listed Companies to have at least 1/3rd independent directors. Certain class of companies to have atleast 1 women director.
29. Disclosures in Board's Report	Section 217 contains disclosure requirements of Board's report	Additional Disclosures proposed by the bill, namely, Extract of Annual Return, Number of board meetings, CSR initiatives and policy, particulars of loans, guarantees, investments etc

30. Compulsory Consolidation of Accounts	Consolidation is not mandatory. Balance Sheet of subsidiary to be attached by holding company while filing return to ROC.	Consolidation is mandatory in addition to standalone statements.
31. Corporate Social responsibility	No Provisions for CSR initiatives	Constitution of Corporate Social Responsibility (CSR) Committee of the Board is compulsory for companies: - having net worth of rupees 500 crore or more, or - turnover of rupees 1000 crore or more or - a net profit of rupees 5 crore or more during any financial year. Every financial year atleast 2% of the average net profits of last 3 years to be spent on CSR activities, otherwise reason for not spending to be given in Board's Report.

3. Transfer Pricing (as a Cost & Management Accounting tool)

The price at which divisions of a company transact with each other. Transactions may include the trade of supplies or labour between departments. Transfer prices are used when individual entities of a larger multi-entity firm are treated and measured as separately run entities.

The price charged to the interdivisional transfer of goods and services is revenue to the selling division and cost to the buying division. Therefore the price charged will affect the profit of both divisions; benefit to one division can created only at the expense of the profit of other division.

For example, the selling division will benefit from charging higher prices for such transfers of goods and services. However, for the buying division this will result into higher costs. The transfer prices, thus, can have impact on the evaluation of each division's performance and measures applied for such measurements of performance.

Requisites of Sound Transfer Pricing System

(i) It should be simple to understand and easy to operate.

(ii) It should enable fixation of Fair transfer prices for the output transferred or service rendered. A divisional manager who considers the transfer price to be unfair to the division would be de motivated.

(iii) It is profitable to allow the divisional managers to sell a small quantity (5-10 percent) to customers outside the organizations or to buy small quantities from sources outside it.

(iv) The business unit / division should have free access to various sources of market information.

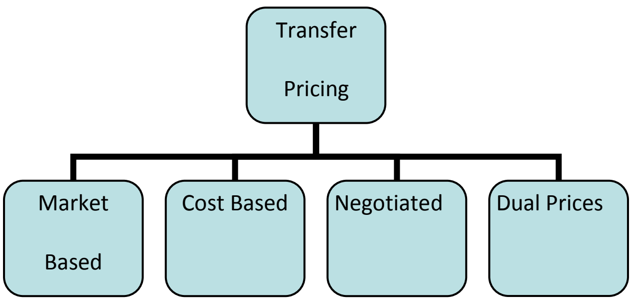
(v) There should be a negotiation for transfer prices between the business unit/divisional managers of the selling business unit/division and the buying unit/ division.

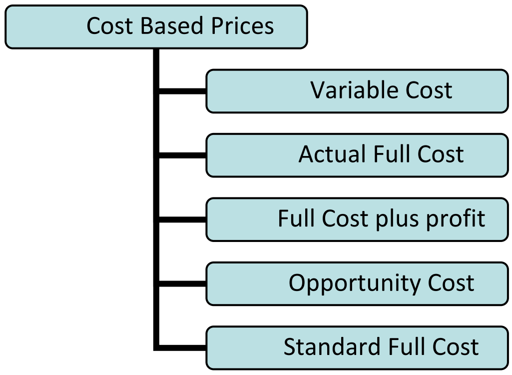
(vi) Top management should discourage prolonged arguments between business unit/divisional managers.

(vii) Transfer prices can be reviewed annually or as dictated by the demand and supply conditions in the market. Transfer pricing guidelines must state the circumstances under which a revision of transfer prices can be made during the year.

(viii) When transfer prices are based on market price, long-term competitive/ normal prices must be considered.

<u>Transfer Pricing - Methods</u>





The Methods of Transfer Pricing can be understood by the fallowing example:-

The XY division of Amco Products manufactures batteries that it sells primarily to the AB division for inclusion with that division's main product. In 2012 half batteries were sold to outside companies at a price of ₹200 each, the remaining batteries went to AB division. Cost data for 2013 for XY division are given below

Production	1,20,00,000
Variable cost	1,20,00,000
Fixed Overhead	60,00,000
Selling expenses (all variable)	30,00,000
Administration expenses	20,00,000

What should be the transfer price for the batteries if company uses:

(i) Market Price

(ii) Variable Cost

(iii) A negotiated transfer price that will yield a markup of 20% on its product cost for XY?

Solution:

(i) Markup price= ₹200 per unit

(ii) Variable cost: =(₹1,20,00,000+₹30,00,000)/1,20,000 unit =₹125 per unit

(iii) Absorption cost= ₹1,20,00,000+₹60,00,000 =₹1,80,00,000

=₹1,80,00,000/1,20,000 units =₹150 per unit

Thus the Negotiated transfer price is:

=₹150+20% (₹150)

=₹150+₹30

=₹180 per unit

We can explain by a Case:-

Supreme Industries Ltd. started as a single plant that produced the major components of electric motors, the Company's main product, and then assembled them. Supreme later expanded by developing outside markets for some of the components used in motors.

Eventually, Supreme recognized into four manufacturing divisions: Bearing, Casing, Switch, and motor. Each of the four manufacturing divisions operates as an autonomous unit.

Supreme's transfer pricing policy permits the manufacturing divisions to sell externally to outside customers as well as internally to the other divisions. The price for goods transferred between divisions to be negotiated between the buying and selling divisions without any reference from top management.

Supreme's profits have dropped for the current year even though sales have increased, and the drop in profits can be traced almost entirely to the Motor Division. Ashok, chief financial officer, has determined that the Motor Division has purchased switches for its motors from an outside supplier during the current year rather than buying them from the Switch Division. The Switch Division is at capacity and has refused to sell the switches to the Motor Division because it can sell them to outside customers at a price higher than the actual full (absorption) manufacturing cost that has always been negotiated in the past with the Motor Division. When the motor division refused to meet the price the switch divisions were receiving from its outside buyer, the Motor Division had to purchase the switches from an outside supplier at an even higher price.

Ashok is reviewing Supreme's transfer pricing policy because he believes that sub optimization has occurred. While the Switch Division made the correct decision to maximize its divisional profit by not transferring the Switches at actual full manufacturing cost, this decision was not necessarily in the best interest of the Company. The Motor Division paid more for the switches than t5he selling price the Switch Division charged its outside customers. The Motor Division has always been Supreme's largest division and has tended to dominate the smaller division. Ashok has learned that the Causing and Bearing Divisions are also resisting the Motor Division's desires to continue using actual full manufacturing cost as the negotiated price.

4. DIRECT TAXATION (Some important issues)

Concept of Assessment Year and Previous Year for taxation of income

PREVIOUS YEAR [SECTION 3]:

- **Previous Year** is the financial year immediately preceding the **Assessment Year.**
- **Income earned during the Previous Year** is normally taxed.

⇩

ASSESSMENT YEAR [SECTION 2(9)]:

- **Assessment Year** means a period of 12 months commencing on 1st April every year.
- Assessment Year is the year in which tax is normally paid, on the income earned during the previous year.

Examples on Assessment Year and Previous Year:

Example 1:

Mr. Keshav had commenced business in 2000. He continued his business in FY 2013-14. The previous year is 2013-14. The Assessment Year is 2014-15.

Example 2:

Mr. Keshav had commenced business in January 2014. The previous year is from 01.01.2014 to 31.03.2014. The Assessment Year is 2014-15.

1. PREVIOUS YEAR FOR UNDISCLOSED SOURCES OF INCOME

SECTION OF THE INCOME	STATUTORY PROVISION
SECTION 68	**Unexplained Cash Credits:** **(i)** Where any sum is found credited in the books of the assessee, about which no explanation is offered in respect of the nature and source of such income, or the explanation is unsatisfactory, or, **(ii)** A closely held company does not offer satisfactory explanation in respect of credit for share application money etc., as mandated in the provisions of this Section, then such unexplained credit shall be deemed to be the income of the assessee for that previous year.
SECTION 69	**Unexplained Investments:** Investments made in the previous year, which are not recorded in the books of the assessee and about which the assessee offers no satisfactory explanation, shall be taxed as income for such financial year.
SECTION 69A	**Unexplained Money:** Money, Bullion, Jewellery owned by the assessee in the previous year, which are not recorded in the books of the assessee and about which the assessee offers no satisfactory explanation, shall be taxed as income for such financial year.

SECTION 69B	**Undisclosed amount of Investments:** Investments made or, money, bullion, jewellery owned by the assessee in the previous year, which are not fully recorded in the books of the assessee and about which the assessee offers no satisfactory explanation, then such excess shall be taxed as income for such financial year.
SECTION 69C	**Unexplained Expenditure:** Expenditure made in the previous year, about which the assessee offers no satisfactory explanation, shall be taxed as income for such financial year.
SECTION 69D	**Amount borrowed or repaid on Hundi :** Amount borrowed or repaid on Hundi, other than account payee cheque, shall be deemed to be the income of the person borrowing or repaying for such previous year.

2. Certain cases when income of a previous year will be assessed in the previous year itself

INCOME EARNED DURING THE PREVIOUS YEAR IS TAXED IN THE PREVIOUS

SECTION 172

Shipping business of a non-resident:

7.5% of the freight paid/ payable to the owner or specified person shall be deemed to be the taxable income.

SECTION 174

Persons leaving India with no immediate intention of returning:

The total income shall pertain to the period starting from the end of the respective Previous Year to the probable date of departure

SECTION 174A

AOP/BOI/ Artificial Juridical Person formed for a particular event:

Assessment shall be done for income up to the date of dissolution.

SECTION 175

Persons likely to transfer property to avoid tax:

The total income shall pertain to the period starting from the end of the respective Previous Year to the date when proceedings are started.

SECTION 176

Discontinued Business:

The total income shall pertain to the period starting from the end of the respective Previous Year up to the date of discontinuance.

5. OPERATION MANAGEMENT AND INFORMATION SYSTEM

Quality Management

Let start the discussion with a small example:

Retail outlets of Bharat Petroleum Corporation Limited (BPCL) who enrolled in the 'Pure for Sure' campaign display the signage (given below) very prominently at the outlet. It is this out-of-box thinking of BPCL that led to stupendous growth of its per station monthly throughput. It's per station monthly throughput grew at least 20,000 litres more than the industry average.

The meaning of Quality:

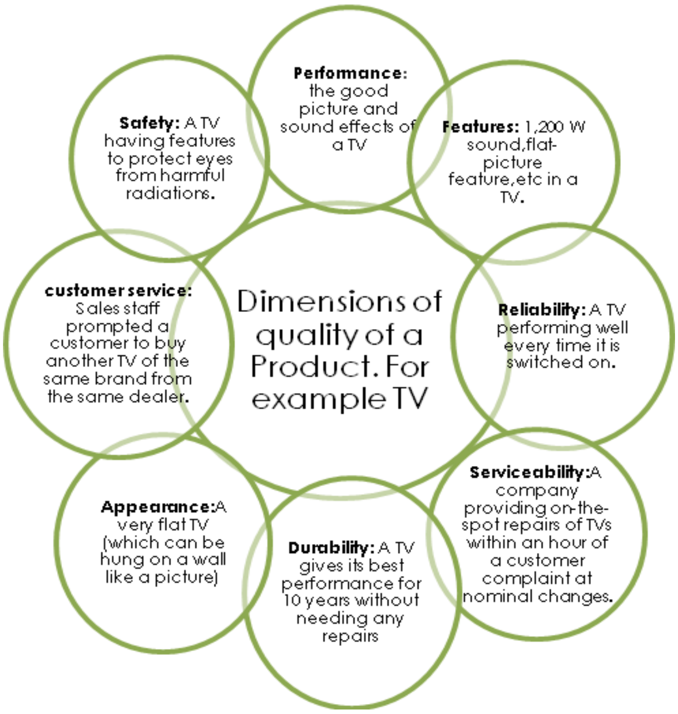
The quality guru J.M. Juran defined quality as 'Fitness for Purpose'. For assessing the quality of a product or service, the criterion of fitness for purpose' is highly subjective, which may vary from individual to individual. The perception of the quality of a product or service from the point of view of a customer may be different from that of the producer. The producer's problem is aggravated by the fact that the number of customers may be too many, and each one may be having a different perception of quality. If a third party, such as a quality certification agency, has to decide the quality of the product or service, its perception may be different from that of both the customer and the producer.

This criterion of 'Fitness of purpose' is perfectly suitable only at a particular stage of production. This is the stage of designing the product or service. The marketing department of the company prepares a product definition document in which it specifies the expectations and requirements of the customer from the product (here onwards we use the term product for products as well as services). This document is passed on to the design department, where the designs of the product are prepared keeping in

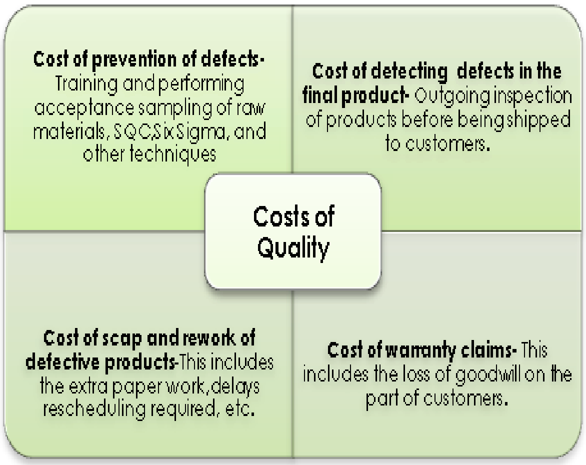
mind the 'fitness for purpose', i.e., the expectations or requirements of the customer. The designs so prepared are rated good or bad according to the extent to which these are able to satisfy the requirements mentioned in the product definition document.

The perception about significance of maintaining quality standards differs from organization to organization. For example, McDonalds aims at serving a greater customer base with standardized products. Whereas, gourmet of French food focuses on quality of cuisine served.

Quality should, first and foremost, be perceived from the customer's point of view. This is because it is the customer who decides whether or not to buy a product or service according to his or her perception of quality.



Cost of Quality:



Important Announcement:

The Intermediate and Final Results for December 2013 Term Examination results are likely to be declared on 21st February 2014. For convenience of the students the online results would be available on the following servers:

1.http://examicai.in

2. http://examicmai.org