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The Management Accountant

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

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IDEALS
THE INSTITUTE STANDS FOR

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

MISSION STATEMENT

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

VISION STATEMENT

"ICWAI would be the preferred source of resources and professionals for the financial leadership of enterprises globally."

DISCLAIMER

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

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The Institute reserves the right to refuse any matter of advertisement detrimental to the interest of the Institute. The decision of the Editor in this regard will be final.

Risk is the hallmark of any business. It is virtually impossible to visualize any business without risk as business and risk are like two close companions. The risk element is not merely confined to business alone but is an integral part of our human life. Risk exists everywhere and in every form which can be perceived by us even in our day-to-day life. For instance, an element of uncertainty may exist as to whether say, rains could be delayed in a particular season or a flight could be cancelled or any journey to be undertaken by rail will meet with an accident etc. When these uncertain events occur, it could result in some kind of loss or damage. This is 'risk'. Thus, uncertainty is a pointer to risk and not risk in itself. In legal parlance, the word 'risk' is used to mean peril, hazard or chance of loss. 'Risk', in commercial parlance, is the chance that expected objectives will not be achieved. It has been defined as the effect of uncertainty on objectives. (ISO Guide 73:2009) There are actually two dimensions of risk – probability and impact.

The origin of the word is believed to be from the Italian word 'rischare' meaning to 'run into danger'. The idea of risk management took some time to develop. It emanated from the sense that a logical, consistent and disciplined approach to an organization's uncertainties will allow it to deal with them prudently and productively, avoiding unnecessary waste of resources. It goes beyond faith (e.g. praying) and luck (e.g. buying a lottery ticket), the twin pillars of managing the future before we began learning how to measure probability, a key idea in thinking about risk. As Peter Bernstein wrote in his book, Against the Gods: The Remarkable Story of Risk, (1997): "If everything is a matter of luck, risk management is a meaningless exercise". From this one may infer risk management to be a nebulous concept. But it is not so. In fact, the rapid changes witnessed in the last one and a half decade of the twentieth century in information technology and in the international financial system served as wake up calls to companies not only operating in the financial services sector but in other sectors as well to conceptualize and devise an appropriate risk management system. Risk management is an integral part of business process which involves identifying and assessing the inherent risks and then responding to them. In practice, it is about identifying the potential variations from what is planned and managing those to maximize opportunity, minimizing loss and improving decisions and outcomes. Risk taking, which is also a part of risk management, involves seizing opportunities. It is a common belief that higher the risk, higher the rewards. Yet, in practice, a higher risk can lead to a much higher loss as well. Hence, appropriate strategies need to be formulated and adopted which would ensure that the organization makes use of the tool to reduce the negative effects to the best extent possible and identify the potential for positive use of risk. Risk management aims to ensure that corporate managers do not take too many unwarranted risks. It is the process of managing risks mainly through :

- Identifying and understanding the risks to the business
- Building vigilance into the organization in a systematic way through effective control, operational measurement and strategic scanning
- Creating a culture that encourages effective risk identification, mitigation and monitoring
- Linking risk management to rewards and resourcing
- Communicating to the organization, its stakeholders and owners.

The rapid changes witnessed in the last one and a half decade of the twentieth century in information technology and in the international financial system served as wake up calls to companies not only operating in the financial services sector but in other sectors as well to conceptualize and devise an appropriate risk management system.

Of late, risk management, as an important element in the financial services has assumed significant importance. Thanks to the sub-prime crisis leading to corporate catastrophe of some of the top notch financial services companies like Lehman Brothers, Bear Sterns which was caused owing to loose credit risk management followed by them. Till late 80's banks practiced a health code to classify the assets and those assets which were not good were provided for but not in a systematic manner. Bad debts were transferred to bad debt accounts but the norms for income recognition and asset classification were not in proper place. Transparency in the balance sheets of risk disclosure was conspicuous by its absence. The opening of the banking system on account of financial sector reforms brought in the IRAC and the capital adequacy norms. Application of these standards depicted the relative weakness of banks. The deregulation of markets brought forth the issue of market risk and the impact that commodity and financial product prices and volatility could have on the balance sheet of banks. The introduction of capital adequacy norms which was gradually raised to the targeted 8% on a uniform basis brought about some financial stability.

As globalization gained momentum, the risks grew in variety and volume resulting in the Basel – II (the Basel committee for bank supervision was formed in 1974) norms and more emphasis on capital adequacy for risk management. The Basel – II framework breaks risks into market risk (price risk), credit risk and operational risk and also specified methods for calculating capital requirements for each of these components. Almost the entire risk management exercise in banks / financial institutions hinges on this three pillar approach to provide greater stability to the financial sector. In India, SEBI effective from January 1, 2006 has inserted Part IV (C) of Clause 49 of the Listing agreement making it mandatory for all listed companies to inform Board members about the risk assessment and minimization procedures. These procedures shall be periodically reviewed to ensure that executive management controls risk through means of a properly defined framework.

One must remember that risk management does not aim at eliminating the total risks as it will be practically impossible to do so. What is required is to shoulder calculated risks and to carry out a 'de-risking' exercise which will call for careful analysis and decision making. 'A decision that does not involve risk is probably not a decision'. Even after adoption of the best of risk management practices, glitches may occur as no system can be full proof. But one has to be optimistic because "A pessimist believes that nothing can be done. An optimist, on the other hand, believes that nothing can go wrong. A realist knows that something can go wrong, but that the situation can be managed. Risk management is realism, and it acts as a necessary counterbalance to an organization's other best resource: optimism."

The greatest thing in the world is not so much as where we are, but in what direction we are moving. **— Anonymous**

M. Gopalakrishnan, President

Dear Professional Colleagues,

It is a matter of great honour to have been elected as President of this great Institution for the year 2011-12. An able Cost and Management Accounting professional, Shri Rakesh Singh has been elected as Vice President of the Institute. I am humbled by the job at hand and grateful for the confidence you have shown and mindful of the expectations you have from me. The baton has passed from the previous to the New Council with new opportunities and associated challenges for the profession. The journey during the last four years was a momentous one, ushering the profession to a new direction.

The newly elected council has started the race brimming with confidence to achieve new peaks of professionalism. This Council has the unique honour of having the first elected lady member in the Council. Each term of the Council leaves its own indelible mark on the path towards progress and the growth story of the profession amply reflecting the efforts made by the Institute. I express my sincere thanks to the entire spectrum of cost and management accounting community who have been offering their best wishes and support.

In the current era of the Indian Growth story, the need for delivering the results faster, smarter and wider have never been felt so much. This council will focus on deliverables within specific time frame to address the requirements of Students, Members in Employment and in Practice, Brand Enhancement through National and International Tie-ups, Government interface, streamlining the Institute Infrastructure with increased Employee involvement to meet the targets. In particular, the focus would be on :

- Improvement of entry standards into the profession.
- Improvement in the quality of professionals to match best global standards.
- Course Structure to be updated continuously in line with other National and International Professional Bodies.
- ICWAI members to be treated at par with other Accounting Professionals both nationally and internationally.
- Centers of Excellence in Management Accounting Research to be established in all four metro cities along with other cities with large industrial bases.
- In all the areas of Core Competency, ICWAI must have strong footsteps to take leadership in diversified areas of operations.
- Institute to develop and issue the remaining Cost Accounting Standards both for the manufacturing and services sector.
- Report on Performance Management with Cost and Management Accounting as the driver with statutory backing.
- Organisation structure of the Institute to be well-defined to have a broader network to serve the remotest corner of the country.
- All the operational units of the Institute to be under same administrative control to have uniformity of operation.
- An established and dedicated electronic mode of communication (such as Video Conferencing) to have on line connectivity with the HQ and other units and also with the users like members, students, etc.
- The main offices of the Institute to have state of the art architecture and infrastructure to cater to the growing needs of the different operational units of the Institute and to act as the nerve center of the various stakeholders.
- The Institute to pursue vigorously and strive for continuous development of knowledge base of the members by introducing various tailor-made

courses in two different modes: (1) On line Courses to enable the members to take up the course at their convenience and (2) Residential Courses to enable the members to have direct interaction with the leaders of the profession and to take up the practical case study, project analysis, research activities etc.

- The Institute to have tie ups with more International accounting bodies.
- Formal agreements and tie ups with apex level chambers of commerce and industry, National Manufacturing Competitive Council, NSIC, etc.
- Tie ups with all regulatory bodies such as RBI, SEBI, TRAI, IRDA, FMC, CCI, AICTE and UGC etc. to understand cost considerations for end users in preparation and implementation of regulations, especially those intimately related to the rapidly growing services sector in the country.
- The website of the Institute to be at par with top international bodies facilitating on line interaction having linkages with regulators and government departments.
- To meet the demands of industry and government in the wake of GST and DTC by producing quality members.
- To undertake research studies for identifying cost consideration, its management in providing education and health care services across the nation with MoUs to be signed with regulators.
- To cater to the needs of the industry for meeting the demands for recent orders on maintenance of Cost Accounting Records and Cost Audit.

Events

After taking over as President of the Institute, Shri Rakesh Singh, newly elected Vice President of the Institute, Shri Sanjay Gupta, Central Council Member and I sought the blessings of Dr. M Veerappa Moily, Hon'ble Union Minister of Corporate Affairs; Shri R P N Singh, Hon'ble Minister of State of Corporate Affairs; Shri D K Mittal, IAS, Hon'ble Secretary (outgoing) to the Government of India, Ministry of Corporate Affairs; Shri Sudhir Mittal, IAS, Hon'ble Additional Secretary to the Government of India, Ministry of Corporate Affairs and Shri Avinash K Srivastava, IAS, Hon'ble Joint Secretary to the Government of India, Ministry of Corporate Affairs by calling on all of them in the week beginning from 25th July, 2011. We also apprised them of the vision of the new council.

Myself, the Vice President and Shri Hari Krishan Goel also met the new Secretary of Ministry of Corporate Affairs, Mr. Naved Masood, IAS and apprised him of the current developments. We also met Shri. V Krishnamurthy, Chairman, NMCC, who expressed his happiness over the role Institute is playing in improving the cost competitiveness of the business enterprises and assured us his support for our cause.

ICWAI has always espoused the cause of the people on the fringes of development by specific initiatives addressed for their benefit. I feel vindicated by an advertisement issued by Ministry of Social of Justice and Empowerment (MoSJ&E), Government of India in the National newspapers recognising the CWA qualification as a prestigious one among other courses in being eligible for concessional loans by its departmental undertakings catering to students from underprivileged class. By this one master stroke on inclusive growth, MoSJ&E has created level playing field for representatives of weaker sections of society.

Our Institute represented by Shri Kunal Banerjee, Shri Brijmohan Sharma (Both Past Presidents of the Institute), Shri Rakesh Singh, Vice President and I participated in wide ranging consultations with the Cost Audit Branch of Ministry of Corporate Affairs, Government of India as the new Cost Accounting Record Rules, 2011 for various regulated industries and provided our inputs.

The new Cost Audit and Cost Accounting Records notification are receiving good response from the practicing professionals. Soon,the Institute will be coming out with guidance note on the same.

I am sure, favourable action will be taken by the Ministry of Corporate Affairs on the Cost and Works Accountants (Amendment) Bill, 2010 dealing with vital issues concerning our profession. The Ministry is also planning to place the new Companies Bill, 2009 before the Parliament which is expected to address the long standing issue on restructuring and simplifying the Corporate Laws.

Technical Directorate

The Central Council of the Institute has approved the release of Exposure Draft of Generally Accepted Cost Accounting Principles (GACAP) Document as recommended by the Cost Accounting Standards Board (CASB), the standard-setting body of the Institute. The proposed document may be modified in light of comments received before being issued in the final form. I urge the members to forward their views/comments/ suggestions on the proposed document latest by September 5, 2011 to the CASB Secretariat. Copies of this exposure draft may be downloaded from the ICWAI website. I am also happy to note that chapters have been proactive in forming special Interest group to deliberate on the GACAP and provide feedback.

Professional Development Directorate

Professional Development Committee, ICWAI has organized a seminar on "Recent changes in Cost Accounting Records and Cost Audit Report Rules, 2011 on 18th July 2011" at Vigyan Bhawan, New Delhi to coincide with the 8th National Award for Excellence in Cost Management-2010". Chairmen, Secretaries and their representatives from four Regional Councils and Chapters attended both the programs. The programme was very interactive and the queries raised thereat were replied by Shri B.B. Goyal, Advisor (Cost), Ministry of Corporate Affairs, New Delhi.

The Professional Development Committee in association with EIRC also organized a programme on Cost Accounting Record Rules and Cost Audit Report Rules on 14th July, 2011. This programme too witnessed lot of interaction between the members and the speakers. The programme was attended by huge number of members including regional and central council members from eastern region.

I am glad to inform members that Ministry of Corporate Affairs has accepted the request of the Institute to permit Cost Accountants also for filing of Balance Sheet and Profit and Loss Account in e**X**tensible **B**usiness **R**eporting **L**anguage (XBRL) mode vide Circular no. 57/2011 dated 28th July, 2011. The Cost Accountants can now do verification and certification of the XBRL document of financial statements on the e-forms. Previous to this amendment, only the Financial Auditors were eligible for such work. I am requesting Regional Councils and Chapters to arrange intensive workshops to train our members.

You will be happy to know Ministry of Corporate Affairs vide its General Circular No. 58/2011 dated 01.08.2011 has issued a revised circular in place of General Circular no. 54/2011 dated 26.07.2011 providing that in each case of winding up petition, the Official Liquidator will file an application praying to the Court to direct the management of the company to submit information duly verified by a **Cost Accountant in Practice** besides other professionals.

Directorate of Advanced Studies

The Directorate of Advanced Studies has finalized its plan to launch the post qualification courses on "Business Valuation Management" and "Foreign Exchange Treasury and Risk Management" in September. The courses were announced on July 18, 2011 on the occasion of 8th National Awards for Excellence in Cost Management-2010. The registrations will be open in the second week of September 2011. The course on Foreign Exchange Treasury and Risk Management is in association with MCX Stock Exchange. The Members of the Directorate have begun research on another innovative programme entitled "Valuation of Financial Intermediaries" in association with a premier Bankers Training Institute functioning under the aegis of RBI.

CEP Directorate

The CEP Committee has organized five programmes during July, 2011 on Cost Accounting Standards, 'NHAI' In-house Programme – Finance and Accounts, Certificate Course for 'Indian Navy' on `Finance, Accounting, Costing, Project and Contract Management, 'Airports Authority of India' Programme on International Financial Reporting Standards and 'Rural Electrification Corporation' Programme on Corporate Tax Planning.

Journal Department

The Management Accountant journal, being the official monthly publication of the Institute, seeks to cater to the needs of members, and students alike by publishing industry focused and relevant articles in different functional areas of management and on contemporary issues related to business, industry, economy, finance, taxation, technology, capital markets, governance and a host of other important issues having bearing to the profession. With multiplicity of core competency areas bringing about a significant change in the profession, the journal department attempts to bring those areas within the knowledge of the esteemed members with special emphasis on a particular theme or subject for every month. Efforts are on to continually upgrade the qualitative aspects of the journal by inviting articles from academicians, practicing members, and corporate professionals on topics which would benefit the members of our profession and in service. I request all the subject experts in various industries to share their knowledge through the medium of journal.

SAFA Meetings

Shri. A N Raman, President, South Asian Federation of Accountants (SAFA) was accompanied by Shri. B M Sharma, immediate Past President of the Institute and Shri Sudhir Sharma, Joint Director, ICWAI as Executive Secretary, SAFA to attend the meeting of General Assembly of SAFA held at Karachi, Pakistan on 25th July, 2011. This was studded by celebrations of Golden Jubilee of Institute of Chartered Accountants of Pakistan (ICAP) and meetings under the aegis of SAFA hosted by Institute of Cost and Management Accountants of Pakistan (ICMAP) on 24th July, 26th July and 27th July, 2011 respectively.

With best wishes for Rakshbandhan, Independence Day, Janmashtmi and Id-ul-Fitr,

With warm regards,

(M Gopalakrishnan)
President,
3rd August, 2011

M. Gopalakrishnan, President

ICWAI takes pride in announcing Shri M. Gopalakrishnan as the new President for the period 2011-12. He is a Fellow member of the The Institute of Cost & Works Accountants of India and The Institute of Chartered Accountants of India.

Shri Gopalakrishnan has been a member of the Central Council of ICWAI for the terms 2004-07, 2007-2011 and for the current term. He has served as the Vice – President of the Institute in the year 2010-11. He was the chairman of the Journal committee of the Institute for the period 2010-11 during which he provided a unique direction and shape for improvement of the qualitative aspects of 'The Management Accountant' journal. He was the Chairman of Cost Audit and Assurance Standards Board of ICWAI in 2009-10 and the past chairman of the Cost Accounting Standards Board of ICWAI. During his chairmanship, he spearheaded the new approach to Cost Accounting Standards aligning with International practices. He represented ICWAI in the Expert group formed by the Ministry of Corporate Affairs, Government of India, on review of Cost Accounting Records, Cost Accounting Standards and Cost Audit Report Rules. He played a pivotal role in taking many initiatives such as centralized campus interview, Technical publications, India corporate week celebrations, Investor awareness week, and Green initiative in the Southern region. He also represented ICWAI in the Accounting Standards Board of The Institute of Chartered Accountants of India.

He is a regular speaker at various conferences on Total Cost Management, Cost Accounting Standards, Performance Management, Balanced Score Card, Performance Metrics, integrating ERP to Performance Reporting and Cost Management Maturity model of CII. He has been involved in many key programmes of the ICWAI such as the National Convention at Chennai, First Global Summit on Management Accounting (2008) at New Delhi and other various programmes as Chairman, Technical committee. He was also instrumental in organizing the 8th National award for Excellence in Cost Management function which was held at Vigyan Bhawan, New Delhi on 18th July 2011 where prizes were given to select public sector and private sector companies for best practices in the areas of Cost Management.

Shri Gopalakrishnan served in the Southern Regional Council of ICWAI from 1990-97. He was the Chairman – Southern Region of ICWAI for the year 1996-97, during which the Southern Regional Council of the ICWAI was associated with Total Cost Management movement jointly with the Confederation of Indian Industry (CII) of the Southern Region. During the same period, he also spearheaded the initiative for cost evaluation of new technologies in collaboration with The Indian Institute of Technology, Madras supported by a MOU with IIT, Madras.

Shri Gopalakrishnan is a practicing Cost Accountant since 1983. He is the senior partner in S. Mahadevan & Co. Cost Accountants, which was established in 1979. His core areas of practice have been Activity Based Costing, Balanced Score Card, Performance Management Solutions and Business Intelligence for the manufacturing and service sectors. He is an advisor to several listed companies and is also associated with new technology tie up ventures for R & D set-ups with various consumer durable manufacturers.

We wish Shri Gopalakrishnan the very best for the present challenge as the President of The Institute of Cost and Works Accountants of India.

Rakesh Singh, Vice-President

ICWAI is pleased to announce the appointment of Shri Rakesh Singh as the new Vice President of the Institute for the year 2011-12. He is an Honours Graduate in Commerce from Deshbandhu College, New Delhi. and a Fellow Member of The Institute of Cost & Works Accountants of India. He is a Practicing Member and a Partner of Shome & Banerjee, Cost Accountants. A vibrant and dynamic personality, Shri Singh was a member of the Central Council of the Institute during the 2004-07 term and has been elected to the council of the Institute for the term 2011-2015. Earlier Shri Singh, as a member of the Northern India Regional Council, held the position of Chairman during the year 2001-2002.

Shri. Singh has, in the past, represented the Institute in various committees including Executive Committee, Examination Committee, Membership Committee, Cost Accounting Standards Board etc. Shri. Singh as Chairman of the membership Committee was instrumental in introducing member's identity card and revision of code of ethics. He has also represented ICWAI in the South Asian Federation of Accountants (SAFA),

His vision is to position the Institute in the global context by spreading the consciousness on cost and management accounting and cost audit in every sphere of economic activity duly integrated with total cost management.

We wish Shri Singh all success in his new responsibility as Vice-President of ICWAI.

TCA Srinivasa Prasad, Chairman

Dear Seniors and Friends,

Greetings to you all

As Chairman of the Journal Committee 2011-12, I am pleased to present myself before you through this medium and I am also thankful to the Institute for giving me this honour.

You will agree that, this journal is a base for Knowledge sharing between members on the various fields connected with our profession. Also, this journal gives a helicopter view of the happenings in the various Chapters/ Regions/HQ of the Institute.

As Chairman of the Journal Committee, I humbly request for your value-additions for improving the quality of our journal from our entire readership. This journal is a community effort and with our combined inputs, we can make this a model for the entire world.

It is this my pleasant duty to request our entire membership to send in vibrant and interesting articles concerning current affairs within the country as well as in the world at large. This will serve the dual purpose of engaging the readership as well as expanding our knowledge base.

The magazine is a reflection of our Institute's activities and the interest levels of the membership. There appears to be still a sizable number of Grad-ICWAs who have not taken the membership as well as a good few who have not renewed their membership. If you, dear reader, are in touch with any of them, your good office in bringing them to the membership-fold can be of immense help, as the contributions from them will also add richness to the journal and in-turn, they will also have the fruits of knowledge update, through this journal.

It is our wish to include in the journal, as many minds of the profession and others as possible, to broaden our awareness of the different aspects industry, profession, governance, technology, management, banking, insurance, taxation, finance, capital markets, and regulatory bodies

The Chapters and Regions are requested to send in their contributions (Activity reports and photographs) well in time for bringing out the same in the corresponding issue itself.

Wishing every one of you and your families, a great time ahead.

With warm regards

TCA Srinivasa Prasad
(Chairman-Journal Committee)
4th August, 2011

THE INSTITUTE OF COST AND WORKS ACCOUNTANTS OF INDIA

Standing & Other Committees of the Council of the Institute for 2011-12

1. Executive Committee	Quorum (4)
1. Shri Gopalakrishnan, M., President	Chairman
2. Shri Singh, Rakesh, Vice President	Member
3. Shri Durga Prasad, A.S	Member
4. Shri Bhattad, P.V.	Member
5. Dr. Bandyopadhyaya, Sanjiban	Member
6. Shri Mohanty, S.C.	Member
7. Shri Goel, H. K.	Member
Secretary ICWAI	

2. Examination Committee	Quorum (3)
1. Shri Gopalakrishnan, M., President	Chairman
2. Shri Singh, Rakesh, Vice President	Member
3. Shri Om Prakash, A.	Member
4. Smt Soman, Aruna V.	Member
5. Shri Apte, Amit	Member
6. Shri Srinivasa Prasad, T.C.A.	Member
Smt Chandana Bose (Sr. Director-Exam)	*Secretary*

3. Finance Committee	Quorum (3)
1. Shri Gopalakrishnan, M., President	Chairman
2. Shri Singh, Rakesh, Vice President	Member
3. Dr. Jagan Mohan Rao, P.V.S.	Member
4. Shri Bhargave, S.R.	Member
5. Shri Gupta, Sanjay	Member
6. Shri Thakur, Manas Kumar	Member
Shri R. N. Pal (Sr. Director-F&A)	*Secretary*

4. Disciplinary Committee	Quorum (3)
1. Shri Gopalakrishnan, M., President	Presiding Officer
2. Shri Durga Prasad, A.S.	Member
3. Shri Srinivasa Prasad, T.C.A.	Member
4. Nominee of Central Government	Member
5. Nominee of Central Government	Member
Shri Kaushik Banerjee [(Director (Discipline)]	*Secretary*

5. Training & Educational Facilities Committee	Quorum (4)
1. Shri Om Prakash, A.	Chairman
2. Shri Durga Prasad, A.S.	Member
3. Smt Soman, Aruna V.	Member
4. Shri Apte, Amit	Member
5. Shri Gupta, Sanjay	Member
6. Shri Srinivasa Prasad, T.C.A.	Member
7. Shri Thakur, Manas Kumar	Member
Shri Arnab Chakraborty (Director-Studies)	*Secretary*

6. Professional Development Committee	Quorum (5)
1. Shri Bhargave, S.R.	Chairman
2. Shri Durga Prasad, A.S.	Member
3. Shri Om Prakash, A.	Member
4. Shri Bhattad, P.V.	Member
5. Shri Goel, H.K.	Member
6. Dr. Bandyopadhyaya, Sanjiban	Member
7. Shri Mohanty, S.C.	Member
8. Shri Goyal, B.B. (Co-opted)	Member
Shri J. K. Budhiraja (Director - PD)	*Secretary*

7. Journal Committee	Quorum (4)
1. Shri Srinivasa Prasad, T.C.A.	Chairman
2. Shri Om Prakash, A.	Member
3. Dr. Jagan Mohan Rao, P.V.S.	Member
4. Shri Bhargave, S.R.	Member
5. Shri Bhattad, P.V.	Member
6. Shri Gupta, Sanjay	Member
7. Shri Mohanty, S.C.	Member
Shri Rajendra Bose (Joint Director–R & J)	*Secretary*

8. Continuing Education Programme Committee	Quorum (4)
1. Shri Goel, H. K.	Chairman
2. Shri Om Prakash, A.	Member
3. Dr. Jagan Mohan Rao, P.V.S.	Member
4. Smt. Soman, Aruna V.	Member
5. Shri Bhattad, P.V.	Member
6. Dr. Bandyopadhyaya, Sanjiban	Member
7. Shri Thakur, Manas Kumar	Member
Shri D. Chandru (Additional Director-CEP)	*Secretary*

9. Members' Facilities & Services Committee	Quorum (3)
1. Smt. Soman, Aruna V.	Chairman
2. Dr. Jagan Mohan Rao, P.V.S.	Member
3. Shri Goel, H. K.	Member
4. Shri Mohanty, S. C.	Member
5. Shri Thakur, Manas Kumar	Member
Shri Kaushik Banerjee (Additional Director-cum-Joint Secretary)	*Secretary*

10. Regional Council & Chapter Co-ordination Committee	Quorum (3)
1. Shri Bhattad, P.V.	Chairman
2. Dr. Jagan Mohan Rao, P.V.S.	Member
3. Smt. Soman, Aruna V.	Member
4. Shri Goel, H. K.	Member
5. Dr. Bandyopadhyaya, Sanjiban	Member
6. Shri Thakur, Manas Kumar	Member
Shri S. R. Saha (Additional Director-F & A)	*Secretary*

11. WTO & International Affairs Committee	Quorum (3)
1. Shri Gupta, Sanjay	Chairman
2. Shri Durga Prasad, A.S.	Member
3. Shri Bhargave, S. R.	Member
4. Shri Bhattad, P.V.	Member
5. Shri Srinivasa Prasad, T.C.A.	Member
Shri Sudhir Sharma (Joint Director-Technical)	Secretary

12. Direct Taxation Committee	Quorum (3)
1. Dr. Bandyopadhyaya, Sanjiban	Chairman
2. Shri Om Prakash, A.	Member
3. Smt. Soman, Aruna V.	Member
4. Shri Gupta, Sanjay	Member
5. Shri Thakur, Manas Kumar	Member
6. Shri Rajaratnam, S. (Co-opted)	Member
Shri Chiranjib Das (Dy. Director - Studies)	*Secretary*

13. Cost Audit Assurance Standard Board	Quorum (5)
1. Shri Mohanty, S.C.	Chairman
2. Dr. Jagan Mohan Rao, P.V.S.	Member
3. Shri Apte, Amit	Member
4. Shri Goel, H.K.	Member
5. Dr. Bandyopadhyaya, Sanjiban	Member
6. Shri Thakur, Manas Kumar	Member
7. Shri Goyal, B.B. (Co-opted)	Member
8. Shri K. Narasimha Murthy (Co-opted)	Member
Shri J. P. Singh, (Director-Technical)	*Secretary*

14. Infrastructure & Information Technology Committee	Quorum (4)
1. Shri Durga Prasad, A.S.	Chairman
2. Shri Om Prakash, A.	Member
3. Smt. Soman, Aruna V.	Member
4. Shri Apte, Amit	Member
5. Shri Gupta, Sanjay	Member
6. Shri Mohanty, S.C.	Member
7. Shri Srinivasa Prasad, T.C.A.	Member
Mrs. Anita Singh (Joint Director-IT)	*Secretary-IT*
Shri Kushal Sengupta (Dy Director-F & A)	*Secretary-Infrastructure*

15. ICWAI-ICAI-ICSI-ordination Committee	Quorum (3)
1. Shri Gopalakrishnan, M., President	Chairman
2. Dr. Jagan Mohan Rao, P.V.S.	Member
3. Shri Bhargave, S.R.	Member
4. Shri Apte, Amit	Member
5. Shri Srinivasa Prasad, T.C.A.	Member
Shri S. C. Gupta (Addl. Director-Admin)	*Secretary*

16. Committee for Accounting Technicians	Quorum (3)
1. Shri Apte, Amit	Chairman
2. Smt. Soman, Aruna V.	Member
3. Shri Gupta, Sanjay	Member
4. Dr. Bandyopadhyaya, Sanjiban	Member
5. Shri Venkataraman, G.N. (Co-opted)	Member
Shri L. Gurumurthy, (Director-CAT)	*Secretary*

17. Indirect Taxation Committee	Quorum (3)
1. Shri Thakur, Manas Kumar	Chairman
2. Shri Bhargave, S.R.	Member
3. Shri Apte, Amit	Member
4. Shri Goel, H.K.	Member
5. Dr. Bandyopadhyaya, Sanjiban	Member
6. Shri Raveendran, P. (Co-opted)	Member
Shri Chiranjib Das (Dy. Director-Studies)	*Secretary*

18. Corporate Laws Committee	Quorum (3)
1. Dr. Jagan Mohan Rao, P.V.S.	Chairman
2. Shri Bhattad, P.V.	Member
3. Shri Apte, Amit	Member
4. Dr. Bandyopadhyaya, Sanjiban	Member
5. Shri Mohanty, S.C.	Member
Shri Dibbendu Roy (Dy. Director – PD)	*Secretary*

19. Cost & Management Accounting Committee	Quorum (3)
1. Shri Durga Prasad, A.S.	Chairman
2. Shri Bhargave, S.R.	Member
3. Shri Apte, Amit	Member
4. Shri Goel, H.K.	Member
5. Shri Mohanty, S.C.	Member
Shri Tarun Kumar (Dy. Director-Technical)	*Secretary*

20. Committee for Advanced Studies	Quorum (4)
1. Shri Gopalakrishnan, M., President	Chairman
2. Shri Durga Prasad, A.S.	Member
3. Shri Bhargave, S.R.	Member
4. Shri Bhattad, P.V.	Member
5. Shri Gupta, Sanjay	Member
6. Shri Om Prakash, A.	Member
7. Dr. Bhattacharyya, Asish K. (Co-opted)	Member
Dr. Alok Pandey (Director – Adv Studies)	Secretary

21. Committee on Banking & Insurance	Quorum (3)
1. Smt. Soman, Aruna V.	Chairman
2. Shri Durga Prasad, A. S.	Member
3. Shri Goel, H. K.	Member
4. Shri Srinivasa Prasad, T.C.A.	Member
5. Shri Thakur, Manas Kumar	Member
Shri Pradipta Gangopadhyay (Dy. Director-Adv Studies)	*Secretary*

22. Committee for Members in Indsutry	Quorum (3)
1. Shri Srinivasa Prasad, T.C.A.	Chairman
2. Shri Bhattad, P. V.	Member
3. Dr. Jagan Mohan Rao, P.V.S.	Member
4. Shri Gupta, Sanjay	Member
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23. Cost Accounting Standards Board

1. Shri Singh, Rakesh	(Council Member–ICWAI)	Chairman
2. Shri Om Prakash, A.	(Council Member–ICWAI)	Member
3. Shri Bhargave, S.R.	(Council Member–ICWAI)	Member
4. Shri Mohanty, S.C.	(Council Member–ICWAI)	Member
5. Shri Goyal B. B.	(Adviser Cost, Govt. of India)	Member
6. Dr. Bhattacharyya, Asish K,		Member
7. Shri Vasudeva, S.C.		Member
8. Shri Muraliprasad, S. A.		Member
9. Dr. Gandhi, Sailesh,		Member
10. Shri Banerjee, Kunal		Member
11. Shri Raman, A.N.		Member
12. Shri Sharma, Brij Mohan		Member
13. Shri Mukhopadhyaya, Asim K.		Member
14. Shri Ganesan, Murali		Member
15. Nominee of MCA		Member
16. Nominee of CBEC		Member
17. Nominee of CBDT		Member
18. Nominee of ICAI		Member
19. Nominee of ICSI		Member
20. Nominee of SEBI		Member
21. Nominee of CCI		Member
22. Nominee of TRAI		Member
23. Nominee of PRB		Member
24. Nominee of CII		Member
25. Nominee of FICCI		Member
26. Nominee of ASSOCHAM/PHDCCI		Member
Shri J. P. Singh (Director–Technical)		*Secretary*

24. National Task Force on CARR & CAR

1. Shri Puri, J.K.	Past President	Chairman
2. Shri Kalyanaraman, V.	Past President	Convenor
3. Shri Bose, B.D.	Past President	Member
4. Shri Joshi, D.V.	Past President	Member
5. Shri Wadhwa, Chandra	Past President	Member
6. Shri Banerjee, Kunal	Past President	Member
7. Shri Sharma, B.M.	Past President	Member
8. Shri Goyal, B.B.	Adviser Cost, Govt. of India	Member

[President and Vice-President are Permanent Invitees to all the Committees.]

Risk Management in Banks and Financial Institutions

Dr. Sankarshan Basu*

Introduction

Risk Management as a key element of the financial sector has been very well recognised for over two decades now. In fact, during this time there have been significant developments in this space. Actually, in some respect, the development of risk management as a key tool in the Banking and Financial Services industry can be traced back to the formation of the Basle Committee on Bank Supervision in 1974. However, never before was the need for risk management in the Banking and Financial Services industry felt more than in the financial crisis period of 2008 – 2009. It is interesting to note that most of the challenges to the financial sector, even the ones during the crisis period of 2008-2009, emanated from various risk practices followed or overlooked, as the case may be. Numerous examples have been cited in the literature of failure in risk practices followed—classic examples being that of the failure of Bear Sterns, Lehman Brothers in 2008 and Long Term Capital Management in 1998, as well as the near collapse of AIG in 2008. Apart from this, there have been numerous other failures that have happened in the banking and financial services domain. A lot of it can be traced to the rapid changes in the international financial system—resulting in newer sources of, and transmission mechanisms for systemic shocks. Financial Institutions (FIs) are faced with the challenge of achieving business growth and profitability while managing risk. The need for effective risk management has never been felt more strongly that now.

The best-practice risk management in the financial services industry has been driven by four major business and risk trends :

1. Globalisation of increasingly competitive and interconnected financial markets
2. Rapid technological changes and improved risk models
3. Increased complexity of products
4. Heightened board and regulatory scrutiny intensified by drastic implications and well-publicised failures.

The consequence of the facts above is that any FI that wants to remain profitable has to be constantly prepared to face the challenges and exploit the opportunities offered in the market. The underpinning of this concept is based on the capacity to manage risk and use it to increase shareholder value and generate a competitive advantage. However, one thing that merits mention and is of paramount importance is that risk management is an ongoing saga and new methods of risk management are developed on a regular basis—given the new sources of risk that are getting generated on a regular basis.

An FI operating as a financial intermediary is inherently in the business of taking risks—Risk management should, therefore, be the cornerstone of its business.

The risk management philosophy of a FI can thus be summarised as :

1. Risk is an inherent part of a FI's business, and effective risk management is critical to achieving financial soundness and profitability—the basic edifices for any successful business.

2. A FI has to identify risk management as one of the core competencies for the future to maintain its niche in the market.

3. The goal should be to understand, measure and monitor the various risks arising during the course of business. It is important to note that the risks contained in the FI's principal activities—i.e., those involving its own balance sheet and its basic business—are not always entirely borne by the FI itself.

From the days the Basle I draft was proposed, there have been significant changes in the market structure as well as risk factors. The Basle I accord looked at the risk-based capital requirements to deal with the weaknesses in the leverage ratio as a measure for solvency. The Accord requires internationally active banks in the G10 countries to hold capital equal to at least 8% of a basket of assets measured in different ways according to their riskiness. The definition of capital was set (broadly) in two tiers—Tier 1 being shareholders' equity and retained earnings, and Tier 2 being additional internal and external resources available to the bank. The bank was required to hold at least half of its measured capital in Tier 1 form. A portfolio approach was taken to the measure of risk, with assets classified into four buckets (0%, 20%, 50%, and 100%) according to the debtor category. However, this accord remained a non-starter with many member

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countries not approving these norms. This led to the introduction of the Basle II norms. The objectives of the Basle II norms were Promotion of safety and soundness in the financial system, Enhancement of competitive equality, A more comprehensive approach to addressing risks, Development of approaches to capital adequacy that are appropriately sensitive to the degree of risk involved in a bank's positions and activities; and focus on internationally active banks, and, at the same time, keep the underlying principles suitable for application to banks of varying levels of complexity and sophistication.

Basle II norms were published in 2004 and consisted of three pillars :

1. The First Pillar : Minimum capital requirements, which seek to refine the standardized rules set forth in the 1988 Accord;

2. The Second Pillar : Supervisory review of an institution's internal assessment process and capital adequacy; and

3. The Third Pillar : Effective use of disclosure to strengthen market discipline as a complement to supervisory efforts.

However, before Basle II could be fully implemented across all nations, the crisis of 2008-2009 cropped up and Basle II was shelved. The plans now are to introduce Basle III to address most of the issues that arose during the 2008–2009 crisis.

One of the key things that came out of the 2008-2009 crisis was the fact that most banks and financial institutions had a lot of potentially risky assets that did not show up on their balance sheet—notably called the "Off Balance Sheet Items". While having such items made the balance sheets of the firms look good, it was not necessarily the best framework for disclosure of information and, hence, people were not aware of the risks that they were potentially exposed to. The most classic case of this was AIG—this was a company which had significant "Off Balance Sheet Items" but since this was not in the public domain, its credit rating continued to be very high even though in reality it should have dropped significantly. Furthermore, when the balloon burst, there was big mess with AIG requiring a huge amount of US Government money as a bailout. Incidentally, it was not AIG alone in this problem—a lot of banks, both commercial and investment banks, were also affected in the same manner. Notable amongst them was Bear Sterns and Lehman Brothers who had to close down operations as they did not have any money to run. Others like Goldman Sachs and J. P. Morgan had to change their charters to access Federal funds and still others like Citibank also required high levels of bailout.

What were the key points that one could learn from such scenarios? The most important learning to my mind is the fact that things need to be transparent and in public domain so that potential risk accumulation is reduced. However, on a more technical basis, risk management techniques need to be in tune with the kind of business that a firm undertakes—in other words both have to be on the curve and, if anything, the Risk function should be ahead of the curve for an effective risk management process.

The basic issue that Banks and Financial Institutions should accept and more importantly imbibe on to themselves is the fact that Risk Management is not a useless investment. It is a highly important and useful investment. The challenge is to make use of this to have apositive impact on its profits and its brand, which indirectly leads to profits. Further, for Banks and Financial institutions, given that they also have a social impact, the need for effective risk management is even higher as a potential loss could lead to significant negative effect on the economy as a whole and the cost of recovering from that is generally way too high—sometimes even impossible to recover from.

Thus, risk management as process should essentially be a way of life for Banks and Financial Institutions. Also, it should never be a function that reports in to the main line function as the objectives are completely different. These two functions should be completely independent and report directly to the highest decision making level in the Bank or the Financial Institution. To sum it up, there is no race for primacy amongst the two sets of function—one has to understand that both are equally important and the best strategy would be balanced approach to both— any shift for the bias could be a recipe for disaster.

Finally, Risk Management, if used effectively, can bring significant benefits to a Bank or a Financial Institution. One has to understand that these organizations are primarily in the business of taking risks and, hence, risk will necessarily exist for them. The segregation of the chaff from the wheat and the subsequent survival depends on effective and dynamic Risk Management policies. At the same time, there will be cases when even with the best Risk Management practices there will be some failures as no system is foolproof. But effective Risk Management also implies learning from these failures and moving on. ❐

Risk Management and Sovereign Wealth Funds

Dr. Harnita Chowdhary*

Capitalism over the last couple of decades has metamorphosed into what has increasingly been termed as *'Financial Capitalism'* or even more broadly *'Financialization'*.This 'Financialization' is characterized by structural shifts of dramatic proportions which took place in a number of countries sometime in the mid- to late 1970s or early 1980s and led to significant increases in financial transactions, the profitability of financial firms and the shares of national income accruing to the holders of financial assets. This globalization of finance and the role of the financial sector in the major economies has, in fact, attained exceedingly gigantic proportions and complex innovative features in recent years.

One such novel financial entity or service which has emerged decisively in the process is what is termed as a Sovereign Wealth Fund (SWF). SWFs, in fact, have been around for decades but have had the spotlight turned on them with the recent financial crisis. Today these institutions are among the largest and most powerful global investors. Along with their growing global financial clout, what are also certainly growing with the SWFs are the associated risk elements. Hence it becomes imperative to strive to understand the relatively less explored but increasingly more important issue of SWFs and risk management.

What are SWFs?

To begin with we need to understand what exactly SWFs are. The *term sovereign wealth fund* was *first used* in 2005 by Andrew Rozanov in an article entitled 'Who holds the wealth of nations?' in a Central Banking journal. The previous edition of the journal described the shift from traditional reserve management to sovereign wealth management; subsequently the term gained widespread use, as the spending power of global officialdom has rocketed upwards.

According to the *International Monetary Fund (IMF)*, SWFs are government-owned investment funds, set up for a variety of macroeconomic purposes. They are commonly funded by the transfer of foreign exchange assets that are invested long term, overseas.

Stephen Jen, a currency analyst at Morgan Stanley, has identified *five key traits* of SWFs. They are (1) sovereign government entities with (2) high foreign currency exposures, (3) no explicit liabilities (such as a national state pension fund), (4) high-risk tolerances, and (5) long investment horizons.

Types of SWFs

SWFs are, in fact, a heterogeneous group and may serve various purposes. Five types of SWFs have been distinguished by the IMF based on their main objective: (i) stabilization funds, where the primary objective is to insulate the budget and the economy against commodity (usually oil) price swings; (ii) savings funds for future generations, which aim to convert nonrenewable assets into a more diversified portfolio of assets; (iii) reserve investment corporations, whose assets are often still counted as reserve assets, and are established to increase the return on reserves; (iv) development funds, which typically help fund socio-economic projects or promote industrial policies that might raise a country's potential output growth; and (v) contingent pension reserve funds, which provide (from sources other than individual pension contributions) for contingent unspecified pension liabilities on the government's balance sheet.

These objectives may be multiple, tending to overlap or change over time. For example, in some countries (e.g., Botswana, Russia) stabilization funds have evolved into funds with a savings objective, as accumulated reserves increasingly exceeded the amounts needed for short-term fiscal stabilization. Depending on their objectives, different investment horizons and risk/return trade-offs result, which has led to different approaches in managing these funds. SWFs with a stabilization objective would put more emphasis on liquidity and have a shorter-term investment horizon than SWFs with a saving objective, where liquidity needs are low.

What Countries Operate SWFs?

The first SWF was established by Kuwait in 1953 as a means to help stabilize the economy from fluctuating oil prices. In 1956 the Gilbert Islands (now Kiribati) established the Revenue Equalization Reserve Fund to manage profits from phosphate mining. Following Kuwait and Kiribati, the next major SWFs were created in the 1970s in the wake of the oil shock. The most recent wave began in the 1990s with the Norway Government Pension Fund–Global in 1990 and continues to this day. In the last five years,

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funds have been established by the United Arab Emirates, Iran, Russia, Qatar and China. At least forty countries now have SWFs.

Size of SWFs

The total value of the assets of SWFs is estimated to be between $1.5 to 2.5 trillion. This is about twice the entire hedge-fund industry's worth, though only one-sixth that of global pension funds. Further, this amount is projected to grow sevenfold to $15 trillion in the next ten years, an amount larger than the current global stock of foreign reserves of about $5 trillion in the world.

Many funds do not disclose much information about their operations and assets—so it is difficult to accurately measure the amount of assets under the management of SWFs. The funds believed to be the largest do not disclose their size, investment strategies, or current holdings. Estimates for the size of the largest fund, the United Arab Emirates' ADIA, for example, range widely between $500 and $900 billion. Reportedly, ADIA has achieved a 20% rate of return for many years and rarely considers deals less than $100 million. The next four largest SWFs are Norway's Government Pension Fund, Singapore's Government Investment Corporation (another Singapore fund, Temasek, is in the top ten), the Kuwait Investment Authority, and the China Investment Corporation. Each of these funds, as well as Temasek and Russia's Stabilization Fund, has assets in excess of $100 billion.

SWFs and Risk

It should be clear by now that SWFs are a unique financial genre. They are an oxymoronic combination of 'State Capitalism'. Hence, the risk associated with them is also complex. The risk is two-pronged and multifaceted. The overall risk is two-pronged in that : One not only do SWFs pose traditional risk issues for their own management as is the case with all asset management, but also beyond, for their nation as a whole, since they deal with sovereign assets. Two, they also pose a very distinctive category of risk—which is socio-political in nature for the institutions and nations that pick up finance from them.

Firstly, Investment risk for Sovereign Wealth Funds has many facets. They mainly include Liquidity Risk, Counterparty Risk, Operational Risk, Market Risk, Macro management Risk, Legal Risk and Reputational Risk, From the nation's point of view they additionally face a Transparency Risk.

Secondly, the geopolitical risk that their clients may face may have facets ranging from politicization risk to management risk to control risk to macro-economic destabilization risk. In fact, the recent activities and projected growth of SWFs have stirred a debate about the extent to which their size may allow them to destabilize financial markets and their policies may be driven by political, rather than economic and financial considerations. In a December 2007 speech before the Gulf Cooperation Council in Bahrain, U.S. Deputy Treasury Secretary Robert Kimmett said that SWF investments "may raise legitimate questions about national security" and "their scale/number and tendency toward lack of transparency raise the possibility of potentially negative impacts on global financial stability if funds operate without prudent governance and investment management standards." Christopher Cox, Chairman of the U. S. Securities and Exchange Commission (SEC), has raised concerns about the conflict of interest that may arise when a fund is owned and managed by the government that is legally required to regulate it. Cox has stated that, in some cases, foreign governments may not be fully cooperative with insider-trading investigations. Cox also expresses concern that SWFs may be the beneficiaries of economic intelligence from national security services.

SWFs and Risk Management

Managing the Investment Risk for SWFs and the originating nations :

Since sovereign wealth funds have long been known for their ability to look toward a long investment horizon, short-term volatility has tended to matter less in their calculations. Events of the past few years, however, have altered this view. To address immediate liquidity needs during the crisis, many funds underwent de-risking where possible, unwinding positions to shore up liquidity, and deferring or dropping investment plans that appeared excessive in the face of widespread uncertainty.

Looking ahead, risk and risk management now carry much greater weight as funds approach investment and allocation decisions. SWFs reflect this risk awareness in many ways. Some, for example, see regional investment markets as safer havens that allow for more careful monitoring. Some are pursuing passive investment strategies. Others are undertaking direct investment with longer-term strategic objectives. Alongside, SWFs are making greater use of risk management tools and performance analytics.

In order to address most of the investment risks detailed above, an ideal template is provided by Norway's SWF. Over the last 35 years Norway has become one of the largest oil and gas exporters in the World. Today petroleum counts for 25 percent of total production in Norway, close to 40 percent of state revenues, and more than half of total exports. The "Petroleum Fund" was enacted in 1990. The first allocation to what is now known as "The Government Pension Fund—Global (GPF-P) came in 1996. Since then it has grown fast, and, at the end of 2007, it had risen to US $400 billion. Over and, above the obvious financial goal of making a good real return (or presently, not losing too much), the fund has two main political objectives—one related to saving and intergenerational distribution, and the other to macroeconomic management.

It is probably crucial for the legitimacy and future sustainability of the operation that it maintains a high standard of accountability and transparency.

A precondition for (formal) accountability is to have a clear division of responsibility and labor. The Norwegian set-up looks like this :

The Fund is formally owned by the Ministry of Finance, while operational management is delegated to Norges Bank, which, in turn, has established a special unit, Norges Bank Investment Management (NBIM), which does the actual running of the Fund. The Bank operates according to a mandate given by the Ministry. The Ministry determines a benchmark and establishes risk limits and guidelines. The fund engages in both index and active management of securities and bonds. Separate units have been built up for this. Parliament receives an annual review of the Fund's performance and management practices in the form of a "White Paper" from the Ministry of Finance. Important changes in management strategy (changes in the mix of equities and bonds being a case in point) also need parliamentary approval before they can be implemented.

Transparency on the other hand does not here mean posturing and a maximization of public conflict. Rather, it consists of a highly technocratic form of authority shielded from public and democratic scrutiny by the sheer complexity of its tasks. NIMB employs techniques and works according to risk-management principles that the ordinary Norwegian (including most members of parliament) has scant chance of understanding. The Fund is also meant to maximize transparency through liberal practices concerning the disclosure of information. For example, the annual reports disclose a list of every single investment held at the end of the year, and it also reports on the corporate governance work done by the NBIM. Seen from the outside, the impression given is that most documents and analyses produced by and for the fund are public. In official documents this is emphasized as a key tool in building trust—both domestically and internationally.

Furthermore, Norway has chosen a strict portfolio model for her fund in the sense that maximum holding in any given company is 5 percent, while the average is around 0.5 percent. This strategy was chosen primarily because it was deemed attractive from a risk-management perspective. Also, taking strategic positions in companies would have implied increased political risk (at home and abroad), while also requiring competencies different from what is required from financially oriented capital management. This strategy is crystallized in a benchmark portfolio set by the Ministry of Finance. The benchmark portfolio serves at least two purposes. It is used both as a risk management tool and as a rod to measure NBIM's performance. The risk management part demands further elaboration: In order to control risk, limits are set for the acceptable deviation between actual investments and the benchmark portfolio.

In addition, in order to factor in socially responsible investment based on ethical considerations, the Fund has set up an Ethics Council which has already begun to play a proactive role. The most celebrated of the divestment cases so far is probably Wal-Mart and the alleged use of child labor in its supply chain.

Finally, the fund was fully integrated into the macroeconomic regime of Norway in 2001. A fiscal guideline that implies that the annual non-oil deficit should, on average over the economic cycle, be limited to 4 percent of the Fund, was agreed upon by a large majority in Parliament. Four percent is assumed to be the long-term expected real return on the Fund, and the target is used with some discretion, but in a symmetrical fashion so that spending can be above 4 percent in a downturn while it should be below at times when demand is strong and the economy is booming. Since 2001, three successive governments have been loyal to this guideline and it still enjoys a substantial majority backing in the Norwegian parliament.

Thus SWF governments need to be typically involved in determining the overall objectives of the funds, the broad investment framework, and the level of risk tolerance within which their funds are allowed to operate. Well-designed SWFs can support sound fiscal and monetary policies, and mitigate Dutch disease effects. At least four policy angles are relevant : fiscal policy, monetary policy, balance sheet implications, and external stability. Good corporate governance of SWFs is a key issue for domestic stakeholders. SWFs need to ensure that adequate risk-management processes and human and systems resources are present to correctly measure and monitor the financial and operational risks, including those arising from external fund managers.

Managing the Geopolitical Risk for the nations receiving SWFs

A unique dilemma is faced by the nations receiving SWFs. On the one side is the world community's collective interest in sustaining the openness of capital markets; and, on the other hand, are the legitimate national security concerns of individual host countries. Some stable and acceptable balance between the two needs to be found. Individually as well as collectively, recipient countries have begun to address the regulatory challenge directly. A range of policies have been put forth. Some have proposed greater scrutiny of foreign government entities seeking operational control of companies in which they invest, particularly if they choose to exercise the voting rights of their equity shares. Others have advocated that SWFs should be allowed to invest only in nonvoting equity shares. In addition, some call for restricting SWFs' operations to reciprocal arrangements, where the ability of a country to buy foreign assets would be conditioned on granting similar access to foreign funds. Further insight into this issue is gained by noting that economic theory suggests that the expanding role of SWFs may be best accommodated by their purchasing shares of a fund composed of the indexes of all the countries forming the global financial system. Some observers call for imposing stringent transparency requirements on SWFs, well above the present requirements on private financial funds.

In this connection, the U.S. Treasury has suggested that the International Monetary Fund and World Bank play an oversight role to limit the systemic risks of unregulated SWFs, including the formulation of best practice guidelines. In October 2008, 26 sovereign-wealth funds, with support from the IMF, agreed to a set of accounting standards and investment practices called the Santiago Principles. The most significant of the 24 guidelines is the principle that the funds should comply with all the disclosure rules of host countries. Over the past year many funds have started publishing annual reports and disclosing their asset allocation, a significant step for a secretive sector. There is still, however, a long way to go. Most disclosures are still short on information. For instance, the first report of Abu Dhabi Investment Authority—one of the largest sovereign-wealth funds—does not say how many assets it has under its management. The Santiago Principles are voluntary, with no penalties for non-compliance.

Conclusion

Post 2008, the world's financial structure has received a massive upheaval. Faith in the existing structure has been shaken from the roots. In fact, the derivative bubble built largely over North America has exceeded the global gross domestic product by a factor of ten (Bank of International Settlements, Basle) and there is yet the story to unfold completely in the Western part of the world. Hence, what is being played out on the larger scene is nothing but an entire economic tectonic shift from the US and Europe to the East—largely China and India. As per the BRIC report, China has already become the number two economy of the world and India will reach this slot by 2043. A New International Order has emerged.

The SWFs are nothing but the the functional and political equivalent of the formal institutions that characterized the original Bretton Woods.They are the anchors of the New International Order and if the risk inherent is managed well, will not only serve to salvage the West, but, in the long run, can still hold the global financial edifice which is threatening to go under. ❐

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Risk based loan pricing—an effective tool for Credit Risk Management in Banking Industry

Ela Sen*

Introduction

In 1980s an extraordinary upsurge in the number of bank failures raised the question regarding effectiveness of bank supervision by regulatory authority. This set Basle Committee on Bank supervision to review the entire situation. The Basel committee, whose secretariat was provided by the Bank for International Settlement in Basle, was established in 1974 by central bank governor of Group ten (G-10) countries and had members from many other countries. The Committee observed that apart from concurrence of several broad national and economic factors, many of the banks assumed excessive risks and were insufficiently restrained by their supervisory authority, a situation which need to be corrected. It was since then that the banks together started to think for managing their risks in a systematic and professional way.

Banking industry forms the brick and mortar of a country's financial infrastructure. Its widespread network, diversities of products, complexities in operation has always made it vulnerable towards many kinds of risks. The process of liberalization, increased cross-border transaction and sophistication in technology has multiplied the risk manifold. Yet the industry used to run on thin equity base. Basle I accord made in 1988 recommended the banks to maintain capital at minimum 8% of their risk weighted assets. Afterwards, Basle II guidelines, initiated in 1999 and finalized in 2004, brought out the revised and more detailed framework for risk management in banks standing on three pillars—namely minimum capital requirements, supervisory review, and market discipline. Basle Committee does not have any regulatory power and its suggestions are implemented by the central banks of respective countries. Today the risk management policy followed by most of the banks is more or less in line with the Basle guidelines.

Credit Risk and its Management

Basle Committee has identified three kinds of risks and advises separate capital charge for each. These are [1]credit risk—arising from a loan contract, [2]Market risk—arising from interest rate, exchange rate fluctuation or so, and [3] operational risk arising from procedural lapses, systemic failure, legal battle etc. Out of these, credit risk is most traditional in nature and of paramount importance. It is the largest contributor in the industry's total risk. Whenever a bank enters into a loan contract it assumes some risk. The risk comes from the uncertainty in payment of principal and interest by the counter-party as also from deterioration in asset quality. Lending being bank's main business, it cannot avoid all risks. But it always prefers to maintain a well-balanced credit portfolio.

The risks generally taken into consideration by bank management for formulating their macro level-policy are —

1. Exposure risk i.e., too high exposure to an individual or group borrower

2. Concentration risk, i.e., risk arising from too much lending to a particular industry or sector

3. Activity risk, when the business is of speculative nature with wide fluctuation in asset value like real estate business, share trading etc., and

4. Country risk associated with the economic and political condition of a country.

Bank carefully evaluates its existing portfolio and sets prudential limit for each risk prone area. Next phase in credit risk management involves risk rating of individual loan in the portfolio. This basically stands on four premises :

(a) Identification of risk
(b) Measurement of risk
(c) Monitoring of risk and, finally,
(d) Mitigation of risk.

Initially Basle accord suggested uniform weight for each loan which was severely criticized. So this was amended and different weights were prescribed for different loans according to their risk category, generally varying from 0 to 150%. This necessitates the banks to make credit risk gradation of each loan to find out the resultant capital charge. To accomplish the task Basle introduced a three stage approach. First stage is the standardized approach where banks will take help of any external accredited agency to rate their loan. In India RBI has approved 5 such agencies viz., CARE, CRISIL, ICRA, SMEERA, and Fitch. All loans above Rs. 10 crores are being rated by them.

In the second phase, a bank, after developing a sound in-house system and infrastructure may, after taking approval from its central bank, switch over to Internal Rating Based Approach, or IRB approach, and rate its own customers. This will indeed be more

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accurate than the previous one as banks possess much discreet information about its customers otherwise inaccessible to others. Third stage is Advanced IRB approach where a finer tuning of the previous one will be done. All the banks have now started to design their own rating system.

Risk based loan pricing—the new concept

Loan pricing is a critical function of a bank or any financial institution. It is generally viewed from a cost accounting perspective. First find out the raw material cost, i.e., the cost of deposit, then add the variable expenses, i.e., the transaction cost and operating expenses as also the fixed cost—the administrative expenses and, finally, the bank's targeted profit. Although it sounds simple, in practice the job is quite difficult as the different allocable cost components are not readily traceable to a particular loan product. In reality, all banks fixs some floor rate on the basis of their average cost and let the market competition be the prime driving force for determining the final rate. Once a bank adopts the policy of risk rating their individual loan assets it generally transpires that these should be priced according to their risk grade. In other words, a risk premium should also be added to their erstwhile risk free rate. The rationale behind it is clear and simple :

1. This follows directly from Risk-Return relationship. If a bank assumes more risk for a particular loan compared to others, it may justifiably claim better return from the same.

2. It helps the banks to set their profit target according to their risk appetite and, thus, allocate fund within their overall risk absorption capacity.

3. Since with a more risky portfolio bank's own rating deteriorates and, consequently, its cost of fund increases, higher return from loans becomes necessary to offset the factor.

4. It helps the bank to attract better quality customers by offering them a competitive rate. Thus their quality of credit portfolio improves.

5. It improves customer relationship and more cross-selling of bank products.

6. It motivates the customers with low credit standing to improve their rating and, thus, get the same loan at a reduced price.

Although apparently the logic as above seems sound and plausible, till some time back banks were hesitant to charge extra risk premium on their loans with the apprehension that it may cause a loss in their bulk loan volume. But empirical study has proved that introduction of risk based pricing not only improves their profitability but increases their loan volume also.

Many companies are now voluntarily rating their business for negotiating loan rates.

Assessment of Risk

Risk assessment of individual facility is the first step in risk based loan pricing. In case of small value loan like loan to individuals, housing loans, education loans, credit card loans etc. risk grading is generally done by considering entire loan bucket as a single facility and uniform risk premium is charged on each loan. The risk associated with the loan bucket is determined after taking into consideration the target group for that facility, design of the product, availability of collateral and past track record for the customer line. The large value commercial loans, however, require a more detailed analysis which is done through the internal rating system of the bank, already mentioned. The system generally uses a standardized risk rating framework. Within the broad framework a number of risk modules are set, tailor, made for different sectors like manufacturing—large or small, infrastructure development, trading, service, finance etc. according to the specific features of each sector.

Success or failure of a business entity depends on the favorable or unfavorable condition of a number of factors and the degree of uncertainty attached to them. These are source of risk and called risk factors. Risk factors are same for every sector but their respective influence may vary from sector to sector. These risk factors are identified, captured in the rating framework, and suitable weights are assigned to them applicable for each module. Each risk factor is then explored to find out the potential risk areas, arranged in a questionnaire form, marks allotted to them, and then placed in a scoring scale ranging from 1 to 10 approx. Finally, marks are awarded against each point within a risk factor, aggregated and reduced to the values according to their risk weights. The summation of scores for all risk factors denotes the overall rating of the loan. Some illustrative examples of risk factors and risk area :

Risk factor	Risk area
Industry risk	Whether the industry is passing through boom period or declining part of business cycle, extent of government regulation, effect of international price fluctuation, availability of infrastructure facility, supply position of raw material and other necessaries etc.
Business risk	Range of product-mix, %age of market share, extent of competition, market demand, customer base, threat from import, chances of obsolescence etc.

Risk factor	Risk area
Management risk	Ownership pattern, legal constitution, promoter's experience, whether managed by professionally qualified bodies, administrative set up, adequacy of book keeping system, extent of automation etc.
Financial risk	Sales volume, return on assets, profitability, cash generated and repayment capacity, net worth position, current ratio, debt equity ratio and other important financial ratios
Past track	Compliance of sanction terms, servicing of interest, instalment, maintenance of financial discipline, mobilization of other business etc.

A substantial part of the rating process depends on the subjective judgment of the assessing officer. Two or more officers are, therefore, involved in the process. Yet the effect of personal impression cannot be overcome. Many a times it is not unlikely to happen that risk rating is done by fitting some preconceived rating for the borrower in the rating framework rather than determining the rating from the process itself. Nevertheless the process is welcome approach for organizing the banker's intuitive risk perception in a systematic and professional manner.

Quantification of Risks

Quantification of risk in a scientific way and fixation of accurate risk premium is perhaps the most difficult task in the entire process. While making a risky loan, bank incurs two types of cost—[1] cost of credit loss, [2] cost of additional regulatory capital. Risk premium should be fixed in a way to ensure adequate return to cover up these two costs. Credit loss has two components, expected and unexpected loss. While undertaking credit activity, banks experience some amount of loss over a time horizon which is called the expected loss and taken care of by general provisioning. If the actual loss exceeds expected loss the difference is called unexpected loss. Unexpected loss is a quantitative estimate of the amount of economic capital required to support a bank's risk taking venture and to save it from insolvency. It is a major contributory factor for determining the risk premium. Credit loss could be ascertained from a credit risk model which is nothing but mapping of default frequency of a particular risk grade over a time horizon. Some models adopt default mode methodologies which considers only a default event correspond to a credit loss whereas a mark to market mode methodologies considers a deterioration in asset quality is also a credit loss. Total credit loss is a function of a bank's exposure, probability of default, and loss given default. Output generally comes out in a form of bell-shaped curve showing expected and unexpected loss separately. To this then cost of regulatory capital is added.

The process actually involves numerous mathematical steps, multiple assumptions and thorough knowledge of statistical theory. Over the last decade a number of risk managers, regulators, academicians and software vendors are trying to develop a sophisticated pricing model with sufficient accuracy, tailor-made for different lines of product or facilities, and flexible enough in responding to current changes. No final conclusion has yet been reached. The complexities of situation and interdependencies and correlation of various factors makes a perfect model designing practically impossible, yet Many assumptions for ideal condition have to be made at the cost of accuracy. Data limitation is another big hurdle—both in regard to their availability and reliability. With extensive research work and advent of technologies the ultimate solution will one day be achieved. Till then the banks are charging a slab-wise risk premium— spread over the minimum and maximum interest spread— according to the risk grade of the individual customer.

Conclusion

Risk based loan pricing has been introduced in our country only 5/6 years back but, by this short time, it has become well accepted within the industry. It is beneficial for both bankers and borrowers. Differential loan rate, in fact, provides greater accessibility to all types of customers. The process is yet in its initial stage and many improvisations in model and methodologies is bound to be made. But, no doubt, the step is well taken. ❐

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Risk Management in Commercial Banks : A Glimpse

K. R. Srivarahan*

"Potential for loss" is perhaps the shortest and yet most meaningful definition of Risk. Risk manifests itself in all our endeavours. If we try to avoid decisions and consequent actions hoping that we can thereby avoid risk, we need to realize that even inaction is fraught with risk.

Commercial banks are in the business of mobilizing deposits, lending money and investing funds. In the process, they encounter risks in the forms, inter alia, of Credit Risk, Market Risk and Operational Risk.

Risk management in commercial banks in India as it is practised now is mainly an offshoot of recommendations of Basel Committee on Banking Supervision (BCBS) modified suitably by Reserve Bank of India. Initial guidelines of BCBS, called Basel I resulted from the 1988 Accord incorporating the agreement of banking institutions from various countries. Basel I was succeeded by Basel II which is now in vogue in India. Discussions are already afoot to usher in Basel III—benefitting from the lessons of the recent global economic crisis.

The fundamental departure of Basel II from Basel I is that the former takes into account operational risk also apart from credit and market risks. The other notable difference is that Basel II is more sensitive to differences in risk profiles of various types (segments) of borrowers.

Credit Risk

BCBS defines credit risk as the potential that a borrower or counter-party will fail to meet its obligation in accordance with the agreed terms. Such risk can arise on account of advances (lendings) or investments made by banks. Credit risk is quantified as the product (multiplication) of (a) Probability of Default, (b) Loss Given Default, and (c) Exposure at Default. Exposure signifies what a borrower or an investee owes to a bank. **[CR = PD * LGD * EAD]**

Credit Risk Management involves proper appraisal of loan applications (or investment proposals), monitoring of borrowal accounts and appropriate recovery measures. Weakness in any of these areas will diminish the effectiveness of credit risk management. Rating of quality of a prospective borrower is crucial. This may be done internally by a bank if the bank has a robust rating model. Alternatively, or as an additional exercise, reliance may be placed on ratings by external credit rating agencies like CRISIL, ICRA, CARE or FITCH. Though the global credit crisis has partially tarnished the image of credit rating agencies, it cannot be gainsaid that they continue to employ objective methods to rate the quality of borrowers.

Banks in India are now following what is known as "Standardised Approach" to credit risk management. Under this approach, the Risk Weight of corporate accounts is decided on the basis of external credit rating only. Risk Weight which is a number in percentage terms like 75%, 100%, 150% etc., gives an indication regarding the regulator's perception of risk arising from exposure to a particular segment of accounts. Borrowal accounts are classified into various segments such as Corporates, Sovereigns, Regulatory Retail Portfolio, Commercial Real Estate etc. If RBI—which is the regulator of banks in India perceives that there is over-lending to any particular segment, or the risk of exposure has increased in that segment, then RBI will enhance the Risk Weight of that segment in order to discourage further lending to that segment. This would happen because a higher risk-weighted segment calls for higher capital requirement on the part of banks. However, if banks gain adequate experience in rating of borrowers, such expertise will enable them to migrate to advanced approaches called "Internal Rating Based" approaches in course of time. Banks which develop competence in internal credit rating will gain enormously in terms of reduced requirement of capital in future. In fact, internal credit rating may become a function of core competence for some banks.

Banks have various prudential norms expressed in their Loan or Credit Policy Documents in the form of Single Borrower Limit, Group Borrower Limit, Sectoral Limit (specifying the maximum exposure tolerated for a specific sector like steel industry), Rating-wise limit on exposure etc. Bank officials are vested with differential lending powers based on their position in the hierarchy. In addition, the system of

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committees is in operation in almost all banks to arrive at recommendations or decisions on credit matters.

Effective monitoring is an essential part of credit risk management. Banks are aware that an open door tempts a saint and therefore make conscious efforts to disincentivise borrowers from misusing or diverting bank funds. One barrier in this area, especially in the case of public sector banks, is the lack of involvement of many staff members in credit monitoring. Banks need to develop better motivational methods to activate employee involvement.

Pricing of credit is an area where our banks have not made much headway. Principles like Risk Adjusted Return on Capital (RAROC) are rarely adopted—if at all. Consequently, mispricing of loans is a frequent phenomenon.

Derivative products for Credit Risk Management

Credit Default Swap (CDS**)** is a very popular derivative product worldwide. RBI has proposed to allow this product in India from October 2011. Availability of CDS was misused on a large scale in the U.S. and this was one of the main reasons for ravages of the Great Recession we are continuing to experience. Collateralised Debt Obligations and their multifarious spawns were responsible for snowballing of the credit crisis. Given RBI's cautious approach, we may be reasonably confident that Indian experience with credit derivatives will not be bitter. RBI has made its intentions clear by stipulating that naked CDS (that is, the option to purchase credit protection without actual exposure) will not be permitted.

Market Risk : Market risk refers to the potential for loss arising on account of fluctuations in interest rates, currency valuations, prices of equity and commodity prices. Therefore market risk includes Interest Rate Risk, Forex Risk, Equity Price Risk, and Commodity Price Risk. Market risk impacts bank's earning potential as well as the valuation of its capital.

Interest Rate Risk : is caused by bank's exposure to deposits and advances/investments which are subject to either fixed interest rates or floating interest rates which are not sensitive enough to variations in market interest rates. When interest rates move up, value of bank's investments in fixed interest securities including Government Bonds typically goes down. The sensitivity of changes in such values to changes in interest rates is captured by the concept of "**Duration**". (Banks in India adopt **"Standardised Duration"** approach in management of market risk.) Duration of an investment is calculated taking into account present value of cash flows and the lengths of time when they occur. An investment with longer duration undergoes greater changes in its value when interest rates turn volatile. An investment whose Duration is 3 (years) will have its value reduced by three basis points when the interest rate moves up by one basis point. **Statutory Liquidity Ratio**—which is presently at 24% of time and demand deposits—necessitates banks in India to compulsorily invest in Government Securities of various tenors. When a commercial bank takes a view that interest rates are likely to move up, it reshuffles its GSec portfolio so that the average Duration goes down. This strategy will ensure that the bank is minimally adversely affected when the interest rates really go up. On the contrary, if the bank's view turns out to be incorrect and the interest rates actually move down, the bank will fail to benefit from reduction in interest rates.

Asset Liability Management (ALM) is an essential element of management of market risk. Through this constant exercise, banks in India endeavour to match their assets and liabilities in various time buckets. Whenever mismatches are noticed, remedial steps are taken which include effecting appropriate changes in interest rates on deposits relating to the time bucket where a **"Gap"** has occurred. **ALM** is also helpful in warding off **"Liquidity Risk"** which may arise because of such mismatches. However, banks in India are acutely aware of the complication resulting from the right of depositors to foreclose their deposits and bank's inability to recall a loan before it is due for repayment. This asymmetric situation creates an **"Options Risk"** for the banker which may make his life nightmarish. The best of ALMs may yet become ineffective due to the presence of this options risk. It cannot be overemphasized that the success of market risk management depends on the bank's ability to foresee the movement in interest rates and behavioural idiosyncrasies (patterns) of depositors and borrowers. Banks in India make use of many derivative products like **Interest Rate Swaps** to manage their interest rate risk more effectively.

Operational Risk : BCBS has defined operational risk as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. **Murphy's Law**—which states—"If something can go wrong, it will"—is the basis for operational risk. One time-tested way of mitigating operational risk is to build **"Back ups"** or **"Redun-**

dancies" in the system. A telling example of necessity for redundancies is the presence of pilot and co-pilot in air flights though most flights are nowadays on auto-pilot system. If one person or system breaks down, a substitute must immediately take over. This is the logic of back-ups. This cardinal principle of risk management is sometimes disregarded in our banks for reasons of economy. Obsessive application of lean management even in crucial areas of operations has led to severe shortage of quality manpower. This may prove to be a glaring example of being penny-wise and pound-foolish.

Organisational structure of Indian banks is such that in order to manage operational risk satisfactorily, close coordination among various departments like Inspection & Audit, Vigilance, Risk Management and Security is called for. Some of the operational risks may also lead to **"Reputation Risk".** For example, frauds committed by employees in banks bring down the image of the banks in the eyes of general public. Frequent failure to observe **"Know Your Customer" (KYC)** norms in many banks is causing concern to RBI. **"Compliance Risk"**—which relates to potential loss of reputation or incurrence of penalties on account of non-compliance with regulatory requirements—is another major constituent of operational risk. Eternal vigilance is the only foolpro of mitigant for operational risk. Dilution in standards while taking/executing documents—especially in the area of loans—is an operational risk that is fraught with grave conse-quences for banks. This **"Legal Risk"** has resulted in some banks coming to grief.

Barings Bank (Nick Leeson) episode : A classic case of operational risk in commercial banks is what happened in the case of Barings Bank more than two decades back. Barings Bank was a well-known British bank with operations in many countries. Nick Leeson was a dealer working for the bank at Singapore. He went on purchasing Japanese stocks hoping that they would appreciate in value. In the process, he acted way beyond his authorized limits (a typical case of failed internal process, an operational risk). This unauthorized behavior of Nick Leeson was either not noticed or perhaps noticed but not taken seriously by the bank because he was usually booking huge profits for the bank. In the meanwhile, a calamitous earthquake struck Kobe, a place in Japan, and Japanese stocks crashed. The loss accumulated by Leeson was so huge that it exceeded the capital of the bank. Hence, Barings Bank was liquidated and sold off piecemeal to various banks. Thus, the unauthorized and overlooked actions of just one rogue trader could sink a bank ! In other words, operational risk can be potent enough to destroy a bank.

Risk and Capital : Under Basel II as regulated by RBI, all Indian banks are advised to keep a minimum capital adequacy of 9% of Risk Weighted Assets. Maximum proportion of such **Regulatory Capital** goes towards credit risk. (Regulatory capital means the capital that is required to be maintained as per instructions of the regulator, namely the RBI. In contrast, **Economic Capital** refers to need-based capital which depends on the efficiency of risk management system in a bank.) Data relating to regulatory capital are published by banks in their annual reports under "**Basel Disclosure".** As on 31st March 2011 the proportion of minimum regulatory capital for some banks was :

	Credit Risk	**Market Risk**	**Operational Risk**
Canara Bank	90%	4%	6%
Indian Overseas Bank	87%	7%	6%
Punjab National Bank	88%	4%	8%
State Bank of India	88%	5%	7%

Basel Disclosure is a treasure trove of information on risk management capability of banks.

ICAAP Document : Nature and intensity of risks may vary from bank to bank. Therefore, RBI requires all banks in India to prepare a self-analytical framework called "Internal Capital Adequacy Assessment Process" (ICAAP) document duly approved by the Board of Directors. This document details in particular the special characteristics of bank's activities which cause exceptional risks peculiar to the bank and how the bank is positioned to measure and manage such risks. Done comprehensively, this is very often a self-revelatory exercise that augments the quality of management.

Conclusion

RBI expects all Indian banks to strengthen their risk management systems and be in readiness to graduate to more sophisticated approaches of management of risk. In order to maximize the gains from risk management, the banks need to look at risk management not merely as a control mechanism but also as a facilitator for improved customer service that will lead to enhanced volumes of business and sustained profits. ❐

Future Contract—A Vital Tool of Risk Management in Financial Market

Dr. L. N. Koli*

In recent years, futures market have become increasingly important in the financial markets. It is essential that all finance professionals understand how futures market work, how it can be used to hedge risk, and what determines prices of them. This paper basically focuses on concept, features and pricing of future contract and social benefits of futures contract as a vital tool of risk management in financial market.

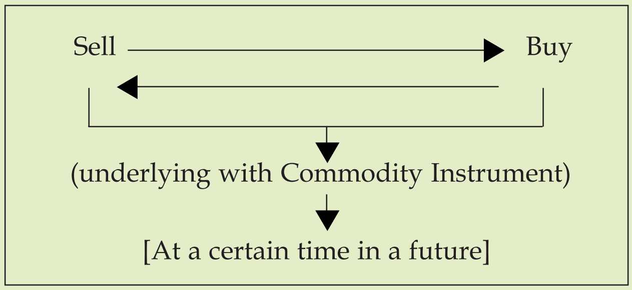
Introduction

Initially, futures markets were engaged in merchandise business only, e.g. egges, butter, cereals, raw material and so on. A significant development in foreign exchange trading occurred in Chicago on May 16, 1972. The International Monetary market (IMM), a division of the Chicago Mercntile Exchange (CME) introduced the world's first futures contracts in international currencies. It is only on this exchange that currency futures have enjoyed any real and lasting success. IMM holds about 90 percent market share in the US currency futures. The other major exchanges which trade currency futures are Singapore International Financial Futures Exchange (SIMEX) and London International Financial Futures and Options Exchanges (LIFFE).

What is Future Contract?

It is easier to describe 'Futures' rather than define it. Futures contract involves an agreement between two parties to buy/sell an asset at a predetermined price on a future date. Investopedia explains Futures Contract. The terms "futures contract" and "futures" refer to essentially the same thing. For example, you might hear somebody say they bought "oil futures", which means the same thing as "oil futures contract". If you want to get really specific, you could say that a futures contract refers only to the specific characteristics of the underlying asset, while "futures" is more general and can also refer to the overall market as in: "He's a futures trader." A contractual agreement, generally made on the trading floor of a futures exchange, to buy or sell a particular commodity or financial instrument at a predetermined price in the future. Futures contracts detail the quality and quantity of the underlying asset; they are standardized to facilitate trading on a futures exchange. Some futures contracts may call for physical delivery of the asset, while others are settled in cash.

A futures contract is an agreement to buy or sell an asset at a certain time in the future for a certain price. It is an agreement to deliver (sell) or take delivery (buy) of a standardized quantity of an underlying commodity/instrument, at a preestablished price agreed on a regulated exchange at a specified future date.



Futures have evolved out of forwards and are exchange-traded versions of forward contracts. They are one of the most popular and widely used derivatives instruments.

Features of Futures Contract

- Futures Contracts are traded on organized exchanges with clearing associations that act as intermediaries between the contracting parties.
- Futures Contracts are highly standardized contracts that provide for the performance of the contract either through deferred delivery of an asset of a final cash settlement.
- Both the parties pay a margin to the clearing association. This is used as a performance bond by contracting parties. The margin paid is generally marked to the market price every day.
- Each futures contract has an association month which represents the month of contract delivery or final settlement, for example—a September T bill, a March Euro, a November Nifty futures, etc.

Though the above description fits equally for a forward contract the following features of Futures Contract make them different from Forward Contracts :

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Bases of Diff.	Future Contract	Forward Contract
1. Size of contract	It may be fixed	It is depend on the terms of contract.
2. Maturity date	The maturity date of future contract may be fixed.	It depends on the terms of contract like, for 3 months, 6 months, 9 months and 12 months
3. Trade location	It is traded at future exchange	There is no fixed location for trade
4. Valuation method	It is valued by Marke-to-market everyday	There is no specific method for valuation
5. Settlement of transactions	They are settled through clearing house	They are settled as per term and condition of the contract

A futures contract is a standardized forward contract. The key differences between forwards and futures are :

● A forward contract is a tailor-made contract (the terms are negotiated between the buyer and seller), whereas a futures contract is a standardized contract (quantity, date, and delivery conditions are standardized).

● While there is no secondary market for forward contracts, futures contracts are traded on organized exchanges.

● Forward contracts usually end with deliveries, whereas futures contracts are settled with the differences.

● Usually no collateral is required for a forward contract. In a futures contract, however, a margin is required.

● Forward contracts are settled on the maturity date, whereas futures contracts are marked to market on a daily basis. This means that profits and losses on futures contracts are settled daily.

Important Futures Exchange Markets in the World

Future Exchanges Markets	Location
CME : Chicago Mercantile Exchange	Chicago
Simex : Singapore International Financial Futures Exchange	Singapore
PBT : Philadelphia Board of Trade	Philadelphia
SFE : Sydney Futures Exchange	Sydney
TIFFE : Tokyo International Financial Futures Exchange	Tokyo
NZFOE : New Zealand Futures and Option Exchange	New Zealand
MACE : Mid-America Commodity Exchange	Mid-America
Chicago Board of Trade, USA	USA
BM & F, Brazil	Brazil
Beijing Commodity Exchange, China	China
New York Mercantile Exchange, USA	USA

Future Exchanges Markets	Location
Matif S.A.	France
London Metal Exchange	UK
Tokyo Commodity Exchange	Japan
Tokyo Grain Exchange	Japan
Sydney Futures Exchange	Australia
International Petroleum Exchange	UK
Coffee, Sugar and Cocoa Exchange	USA
New York Cotton Exchange	USA
Budapest Commodity Exchange, Hungary	Hungary
Kanmon Commodity Exchange	Japan
London International Financial Futures Exchange	London
New York Financial Futures Exchange	New York
New York Financial Instrument Exchange	New York

Concept of Futures Contract

1. Futures contracts are legally binding agreements to buy or sell a predetermined quantity of a commodity of a specified quality at a predetermined future date and price.

2. A long position means one agrees to buy and a short position means one agrees to sell.

3. These are organized exchanges with respective clearing houses for trading of futures. Exchanges usually have two types of members—floor brokers and floor traders.

4. A futures contract should specify the exact nature of the asset, price, contract size, delivery arrangements, delivery months, tick size, daily fluctuation limits, and trading units.

5. There are three types of margins in futures market: initial margin, maintenance margin, variation margin.

6. There are various types of orders in the futures market which can be divided into market orders, market-if-touched, time orders, limit orders, market-on-close orders, discretionary orders, stop-loss orders, exchange for physicals orders, not spread orders.

7. The settlement procedure can be by physical delivery, cash settlement, offsetting and exchange of futures for physicals.

8. Basis means the difference between the cash price and the futures price of a commodity and the extent to which the cash price exceeds the future price at a point of time is called the cost of carry.

9. The main motives behind using futures are hedging, speculation and arbitraging.

10. Futures are of various types and depending on the underlying asset, can be divided into physical commodities, foreign currency, interest earning assets or an index.

11. Currency futures are binding obligations to buy or sell a particular currency against another at a designated rate of exchange on a specified future date.

12. Currency risk can be hedged with the help of currency futures, where both the exporter and importers can hedge their positions by buying or selling futures.

Important Traded Futures Currencies & Commodities in the world

Currencies	Commodities
US Dollar	Eggs
Deutschmark	Butter
Canadian Dollar	Cereals
Swiss Franc	Cotton
British Pound	Meat
Japanese Yen	Soybean
Australian Dollar	Black Pepper
New Zealand Dollar	Tea
Euro	Coffee
French Francs	Oil
Mexican Pesos	Raw Meterials

Valuation of Future Contracts

In futures market usually there will be two levels of margins which have to be maintained by the customers once they open accounts for futures trading. Once an order is placed with a member, they have to deposit a specified amount. This amount is called initial margin. This amount depends on different factors like volatility in the price of asset, duration of the contract, quantity of asset, etc. There is another margin which has to be maintained by the customer known as maintenance margin. This can be defined as the minimum margin which a customer must deposit with a member at all times.

Margins are adjusted everyday—depending on the profits made on the day's long and short positions. This mechanism is called marking to market. If, on any day, the margin falls below the maintenance margin then the customers have to raise the margin level to the level of initial margin. This additional margin is called variation margin. This additional margin can be deposited in cash, T-bills or letters of credit. If the futures account generates profits due to price changes then the customer can withdraw funds in excess of the initial margin amount on a daily basis.

The marking-to-market feature of futures contract, which is perhaps its most distinctive feature, may be illustrated with an example. Suppose on Monday morning you take a long position in a futures contract that matures on Friday afternoon. The agreed upon price is, say, Rs.100. At the close of trading on Monday, the futures prices to Rs. 105. The marking-to-market feature means that three things occur :

– First, you will receive a cash profit of Rs.5.
– Second, the existing futures contract with a price of Rs. 100 is cancelled.
– Third, you will receive a new futures contract at Rs. 105.

The marking-to-market feature implies that the futures contracts are settled everyday. Put differently, a futures contract is converted into a sequence of one-day forward contracts.

Pricing of the Future Contact

Pricing of futures is similar to that of pricing of forward contracts, but sometimes, due to its terminology, the pricing of the futures may appear difficult. If someone would like to hold an asset, say, 3-month down the line, he/she can either buy now or buy after 3 months. If he/she preferred to buy after 3 months, them he/she runs a price risk and the cash outlay required to acquire the asset is unknown. One way to avoid price risk is to buy futures on the underlying asset. If he/she buys the asset it involves:

(i) Outlay of funds
(ii) Cost of funds
(iii) Cost of storing
(iv) Returns on the asset (if he buys futures, then it involves)
(v) No outlay of funds (margins are ignored)
(vi) No cost of funds (margins are ignored)
(vii) No cost of storing
(viii) Loss of return on asset.

The basic principle behind the pricing of futures is, therefore, cost carry relationship and reverse cost carry relationship.

Role of Future Contract in Financial Market

1. Future contract helps in cost and risk management. Futures markets provide two important social benefits: risk management through hedging, and price discovery, Cost management is through paperless and cashless transaction. In other words, the purchase or sale of a future contract as a temporary substitute for a cash market transaction to be made at a later date. Usually it involves opposite positions in the cash market and futures market at the same time.

2. Hedgers use futures to shift unwanted price risk to others, usually speculators, who willingly assume the risk in the hope of making profits. In the absence of futures markets, this risk could not be managed as efficiently: the cost of risk to society would be higher, and we would all be worse off.

3. A second benefit of futures market is price discovery, or the market's ability to "discover" true equlibrium prices. Futures markets provide centralized trading where information about fundamental supply and demand conditions for a commodity is efficiently assimilated and acted on and, as a consequence, equilibrium prices determined.

4. The economic benefits of having more accurate prices are well-known. More accurate prices result in a superior allocation of resources because both consumer and producers make better decisions about which commodities to consume, which to produce, how to produce them, and how much to produce and consume in the present versus the future.

Conclusion

Future contract is a vital tool of international financial management through which financial risk can be managed. ❒

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Life Time Achievement Award

Indian Institution of Industrial Engineering Delhi Chapter

Professor AVTAR SINGH is a distinguished Professional & Educationist, and a senior Fellow of The Institute of Cost & Works Accountants of India (FICWA), and started practising as Cost Accountant in 1966. He was consultant to many companies in the field of Value Engineering, Cost Reduction & Cost Audit.

In 1972, New Delhi College of commerce was set up and Prof. Avtar Singh was appointed as its Principal. This was a turning point in his career.

His passion for Education led him to form the Society of Professionals & Vocationals, registered in 1979. Since then, a number of Colleges and institutions have been set up under this Society. Prof. Avtar Singh was on his march to scale heights in the field of education. Eight institutions are already under his care, and few more are on the anvil.

	Strength
● Institutional Polytechnic for Women, Chandigarh	200
● Sri Sukhmani International School, Dera Bassi	1500
● International Polytechnic for Women, New Delhi	1500
● Sri Sukhmani Institute of Engg. Technology	2000
● Sri Sukhmani Nursing College	600
● Sri Sukhmani Hotel Management	150
● Swarn Public School	500
● Sri Sukhmani Inst. of Competitions	150
● Sri Sukhmani School of Management, New Delhi –	Under approval
● Sri Sukhmani Dental College & Hospital	- do -
● Sri Sukhmani Inst. of Medical Sciences & Research (Medical facilities on nominal charges)	

The Indian Institution of Industrial Engineering (Delhi Chapter) feel greatly honored and privileged to confer the Life Time Achievement Award on Prof. Avtar Singh, Chairman of Sukhmani Group of Institutions, on Sunday, the 25th July, 2010.

Challenges in Risk Management in Banks—Role of Management Accountants

P. K. Jayaram*

Post-liberalisation and reform period since 1990s, the Indian banking industry has been witnessing major changes posing unprecedented challenges for sustained growth and profitability. Globalization and resultant influx of the external effects of changes in the global macroeconomic factors made the task tougher both for the players as well as the policy makers. Risk management is a continuously evolving mix of science and art. Rising global competition, increasing deregulation, introduction of innovative products and delivery channels have pushed risk management to the forefront of today's financial landscape. Ability to gauge the risks and take appropriate position on time will be the key to success not only for retaining but also for creating and enhancing value for stakeholders with sustainable competitive advantage for a bank.

The financial crisis of 2007-08 could be far from forgotten. Financial institutions might surely have since re-vamped their risk management system. But, people will have short memories. The general feeling that Indian Banking system have survived the crises—thanks to well regulated and restrained financial sector reforms—could generate a sense of complacency and that the profit motive and incentives could again override risk restraint.

Overview of Risk in financial services

What is risk? Risk is exposure to uncertainty, i.e. Risk has two components viz., uncertainty and exposure to that uncertainty. This can be understood well by the following example:

Uncertainty: If a person jumps out of an airplane with a parachute on his back, he is taking a risk because he is exposed to the uncertainty that if the chute fails to open he will simply fall and die.

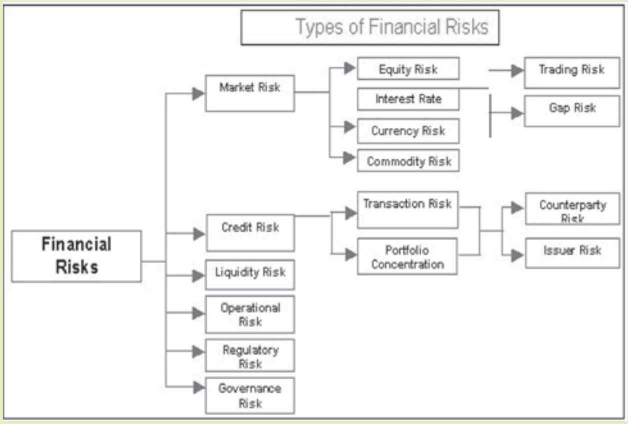
Exposure : A spectator on the ground would not be taking a risk though he is uncertain about the outcome he is watching. But when the spectator is (a) a close relative of the man who jumps with a parachute, or (b) his creditor, he does face risk because he would suffer emotional loss as a relative or financial loss as a creditor having financial exposure to that uncertainty.

Today financial firms operate in increasingly complex, competitive and global markets. The ability to manage risks across geographies, products, asset classes, customer segments and functional departments is critical and management should be keenly aware of the damage that can be done to the brand and bottomline if risk is not managed properly. Besides, rating agencies and analysts are scrutinizing risk management practices as never before.

Today the art of managing risk has never been more challenging—from working with multiple variables to finding technology solutions that generate comprehensive risk analysis.

Types of Financial Risk

Fig. 1



Main types of risk :

Credit risk : Risk resulting from uncertainty in a counterparty's ability or willingness to meet its contractual obligations. eg, A bank gives a housing loan to a customer and his default triggers a total or partial financial loss to the bank.

Operational risks : Risks associated with their back office operations—what came to be called operational risks (risks other than market or credit risks). A back office staff fails to catch a discrepancy between a reported trade and a confirmation from the counterparty. Ultimately, the trade could be disputed, causing a loss.

Market risks : Arises due to uncertainty in the future market value of a portfolio of assets and/or

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liabilities and possible decline in value. Market risk exist in many forms.

Liquidity risk : is financial risk from a possible loss of liquidity. There are two types of liquidity risk : **(a) Specific liquidity risk** is the risk that a particular firm will lose liquidity. This might happen if the firm's credit rating fell or something else happened which might cause counterparties to avoid trading with or lending to the firm, and **(b) Systemic liquidity risk :** affects all participants in a market. It is the risk that an entire market will lose liquidity. Financial markets tend to lose liquidity during periods of crisis or high volatility.

Foreign Exchange Risk : Currency risk is that of potential loss due to changes in exchange rates. This is a component of market risk (a subset of market parameters) where transactions are labeled in foreign currency.

Role of Management Accountants

Discussion on managing risk should obviously include both at micro-level (institution-specific internal enterprise-wide risk management system) as well as at macro-level (banking system, financial system in the country, regulatory bodies etc.). Although recent global events—most notably the global financial crisis—has refocused and intensified interest on risk and the nature of systems in place to manage risk, one area that has received relatively little attention is the inter-relation among risk, risk management and management accounting, and control practices including enhanced role of cost and management accountants in this regard.

Banks are generally considered to convert 'money' as raw material into various products and sell. Actually there are two raw materials viz., money and risk. Some products may involve money only – ignoring 'operational risk' for the time being, a bank might take in 1-year fixed rate time deposit and make 1-year fixed rate loan to its own sovereign, all in domestic currency. By doing so, it may avoid market risk (i.e.foreign exchange and interest-rate risk). Let us assume it manages to avoid credit risk as well. But it is unlikedly to cover its operating cost. Hence, to make a profit, the bank must relax this constraint and take on risk. Thus, it might accept current account and overnight deposits and lend to business firms in different countries. By taking on market and credit risk, it can boost its profits. There are also products that involve risk without money being transferred (other than fee) such as 'guarantees' (called 'non-fund based credit).

Measurement of accounting profit fails to take into account the risks involved in the banking business and thus, as a measure of financial health, accounting profits are highly misleading. No one would take seriously a P&L of a manufacturing firm, say a car-making firm, if it is found to have omitted the cost of steel, rubber, plastics and other raw material inputs from its published accounts even if the labour cost of converting these into cars is included. This is precisely what the omission of the cost of risk from a bank's P&L does. In this case, bank admittedly accounts for the money side of the equation i.e., return on money lent less cost of money borrowed and also the cost of converting this raw material into products (mainly staff cost). Bank also accounts for the return on risk taken, but omits one crucial ingredient—the cost of risk. Interestingly, for financial institutions, the role of capital is not to fund the investment in fixed assets and working capital, but to underwrite the risk taken i.e., the 'unexpected loss' or 'economic capital'. The cost of risk is, therefore, critical. Management Accountants' role is now clearly visible in this function.

Secondly, besides the perennial debate about the cost of capital, a more relevant and important question to be answered is : What is the correct relationship between capital and risk? Hence, What is the correct quantum of capital? Is the banking industry anywhere close to establishing such a paradigm? Can the stakeholders and supervisory community rely on this as virtually the sole process for establishing whether a bank is prudently and properly run protecting the public interest, creating and enhancing value of the stakeholders in the long run?

Undoubtedly global financial industry has progressed, particularly over the past decade, in developing methods to quantify risk. While understanding of the mathematics of market risk has been growing since the late-1950s, measurement of credit risk (such as VaR, CaR etc.) has been much more recent development. Even fifteen years ago, we had neither the financial technology (mathematical model of credit risk) nor the computer technology to measure and manage risk.

However, despite the above tools, we have seen market failures triggered by failure both at the individual bank level or otherwise. Let us look at some of the challenges and possible management accounting role to support combined efforts of the risk managers, technology providers and core banking professional expertise and skills.

Challenges and Opportunities Regarding Implementation of Basel II In Indian Banking Industry

Basel II implementation is widely considered as a significant challenge faced by both banks and the regulators globally. But, Basel II implementation followed by migration to Basel III compliance (detailed discussion of which is out of the scope of this article) has another dimension i.e. it offers considerable opportunities to banks of which two are (i) refinement of risk management systems, and (ii) improvement in capital efficiency.

The role for Management Accountants would include the following areas :

(1) Basel Rules and impact Assessment and Gap Analysis.

(2) Capital/Liquidity, Optimization Analysis and Strategy : As Basel rules are specifically aimed at increasing the quality of capital and reducing risk and leverage, banks should reassess their business, capital, liquidity, and risk strategies.

(3) Risk, Capital, and Liquidity Management Process Enhancements.

(4) Implementation of Basel Rules.

(5) To assist in implementing Stress Testing and Contingency Plans.

Let us first look at the Basel Committee approach briefly. To help banks recognize different kinds of risks and to take adequate steps to overcome undercapitalization of banks assets thereby lessening the credit and operational risks faced by banks, Bank of International Settlement (BIS) set up Basel Committee on banking supervision in 1988. These guidelines brought about standardization and universalization among the global banking committee for risk management and seek to protect the interest of the stakeholders of the bank. Capital Adequacy Ratio (CAR) defined as 'the ratio of capital to risk weighted assets' which provides the cushion to the depositors in case of bankruptcy was considered panacea for risk management and all banks were advised to have CAR of at least 8%. Basel II (proposed in 1999, released in 2004 and as per RBI, banks in India to adopt initially in March 2007 but later postponed to 2009) gave a sound framework for measuring and quantifying the risk associated with banking operations emphasizing flexibility, efficient operations and higher revenue earning potential with full acknowledgement of risks. Basel II made clear distinction between the credit risk, market risk and operational risk stipulating assessment of risk weightage covering all the three categories separately. It also provided a range of options (a) to arrive at the capital requirements for credit risk and operational risk, and (b) to select approaches that are most appropriate for their operations and financial markets.

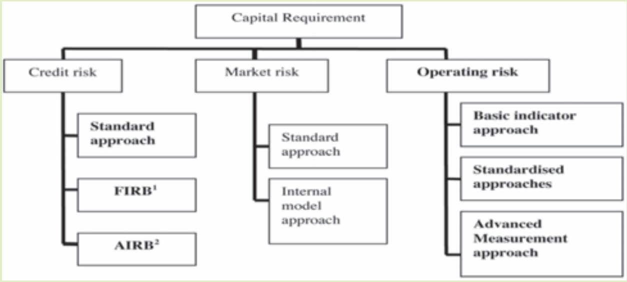
The main objective of the Basel II Accord is to :

- Strengthen the soundness and stability of international banking systems
- Create and maintain a level playing field for internationally active banks
- Promote the adoption of more stringent practices in the field of risk management.

The Basel II Framework consists of three pillars :

1. Calculation of minimum capital requirements
2. Supervisory review
3. Market discipline (public disclosure)

Fig. 2



Notes : The new features (under Basel II) are shown in bold
[1] Foundation internal ratings based approach
[2] Advanced internal ratings based approach

Significant Implications of Basel II

- A significant innovation of Basel II is greater use of assessments of risk provided by banks' internal systems
  - Ability of the bank to determine parameters for probability of default, loss given default, exposure at default, and remaining maturity, which are inputs to supervisory formulas
  - Recognizes evolving nature of credit risk models
- Over time, Pillar 2 will offer the banking industry the opportunity to move closer to internal credit risk models as supervisory concerns are addressed
- Models are important risk management tools but they should be used with a full appreciation of their limitations and in the context of a robust risk management framework
- Capital is not a substitute for effective risk management
- The total amount of capital held by an individual bank is influenced by a variety of factors, of which the minimum regulatory capital requirement is only one
- Banks' business activities and the evaluation of the capital needs of the bank by its board of directors,

the banking supervisors, the rating agencies, and the marketplace also impact the total amount of capital held.

Capital Efficiency

Basel II guidelines compel a transition from the traditional regulatory measure of capital adequacy to an evaluation of whether a bank has found the most efficient use of its capital to support its business i.e., a transition from capital adequacy to capital efficiency. In this transition, how effectively capital is used will determine return on equity and a consequent enhancement of shareholder value. In effect, banks may adopt a more dynamic approach to use of capital, in which capital will flow quickly to its most efficient use. This revised efficiency approach is expected to guide the return-on-equity strategy and influence banks' business plans. With the extension of capital charge for market risks to the AFS (available for sale) portfolio and the coming into force of Basel II norms, banks would need to shore up the capital levels not only for complying with these requirements but also for supporting the balance sheet growth. In order to provide more choices to banks for augmenting their capital levels, RBI has recently permitted banks to issue new capital instruments, including perpetual instruments. A notable feature of these instruments is that these are designed to help banks in not only managing their capital effectively but also efficiently. Critical and ongoing evaluation of the dynamic nature of the bank's financials and implication of choices in decision-making would call for greater role of CMA professionals—an area remains untapped and under-utilised!

Enhancing Corporate Governance

The issues related to corporate governance continue to attract considerable attention in light of a numerous high-profile breakdowns in corporate governance. This becomes all the more relevant for banks, firstly, because (a) not only banks accept and deploy large amount of uncollateralized public funds in fiduciary capacity but also leverage such funds through credit creation, and (b) banks are important participants in the payment and settlement systems. In view of the above, legal prescriptions for ownership and governance of banks in Banking Regulation Act, 1949, have been supplemented by regulatory prescriptions issued by RBI from time to time.

Secondly, because of the importance of the banking system for financial stability, sound corporate governance is not only relevant at the level of the individual bank, but is also a critical ingredient at the system level. Effective risk management systems determine the health of the financial system and its ability to survive economic shocks. To a large extent, many risk management failures reflect a breakdown in corporate governance which arise due to poor management of conflicts of interest, inadequate understanding of key banking risks, and poor Board oversight of the mechanisms for risk management and internal audit. Though the recent FSR report (Financial Stability Report) released by the RBI sounds Indian Banking System is stress-free and stable for now, it continues to be fragile in the global environment. (FSR contains the assessment of the incipient risks to financial stability based on several key aspects including latest techniques of risk assessments such as financial sector infrastructure, macro-economic setting, policies markets and institutions including stress tests). Corporate governance is, therefore, the foundation for effective risk managements in banks and thus the foundation for a sound financial system. Therefore, the choices which banks make when they establish their risk management and corporate governance systems have important implications for financial stability.

A good "governance culture" is crucial for financial stability but, since it is an 'intangible', rules may not be able to capture its essence effectively. Therefore, banks may have to cultivate a good governance culture building in appropriate checks and balances in their operations. There are four important forms of oversight that should be included in the organisational structure of any bank in this regard, viz., (1) oversight by the board of directors or supervisory board; (2) oversight by individuals not involved in the day-to-day running of the various business areas; (3) direct line supervision of different business areas; and (4) independent risk management, compliance and audit functions.

In addition, it is important that key personnel are fit and proper for their jobs. Although some ownership structures might have the potential to alter the strategies and objectives of a bank, these banks will also face many of the same risks associated with weak corporate governance. Consequently, the general principles of sound corporate governance should also be applied to all banks irrespective of their unique ownership structures. The role of CMAs in this context would include developing a methodology and measurement system to assess, monitor and improve the 'invisible' or 'intangible' drivers of good governance.

Compliance with International Accounting Standards

One of the prime international standards considered relevant for ensuring a safe and sound banking system is the 'Core Principles for Effective Banking Supervision' issued by the Basel Committee on Banking Supervision (BCBS). Accounting standards are now a part of the set of twelve standards that have been identified by the Financial Stability Forum as conducive to a robust financial infrastructure. Financial reporting and prudential supervision have slightly different perspectives. While the former is oriented towards capturing the historical position, the latter has a forward looking element—particularly with reference to measurement of impairment and capital. An important challenge, therefore, is to ensure that accounting standards and prudential frameworks are mutually consistent. While working towards achieving this consistency between the two sets of standards, it is essential for the regulators to be in a position to address any implications that the changes in accounting standards may have for the safety and soundness of banks. The IFRS convergence process will involve significant challenges for the banking system in general. Here again, well trained CMAs have good scope to specialise in this area and contribute significantly.

Outsourcing Risks

Increasing tendency among banks to outsource some of its functions/services has compelled RBI to issue specific guidelines (circular in Nov. 2006) in this regard covering the outsourcing process, agreement, evaluation of risks, compliance risk, operational risk, legal risk, exit strategic risk, counterparty risk, country risk, contractual risk, concentration and systemic risk etc including confidentiality and security considerations. Typically, outsourced financial services include applications processing (loan origination, credit card), document processing, investment management, marketing and research, supervision of loans, data processing and back office related activities etc.

The underlying principles for any outsourcing arrangement by a bank are that such arrangements should neither diminish the bank's ability to fulfil its obligations to its customers and the RBI nor impede effective supervision by RBI. Outsourcing banks, therefore, should take steps to ensure that the service provider employs the same high standard of care in performing the services as would be employed by the banks if the activities were conducted within the banks and not outsourced. Accordingly, banks are not expected to outsource any activity that would result in their internal control, business conduct, or reputation being compromised or weakened. Management Accountants are well suited to render professional advice to the management in this regard.

Role of Technology in Risk Management

Seldom one recognizes that the risk management is primarily about people—how they think and how they interact with one another. Technology is just a tool. Like a knife in the wrong hands, it is not only useless but dangerous, but applied appropriately, it can transform an organization. A good approach would be to start planning a risk management strategy focusing on procedural and cultural issues of risk management. Technology can reshape corporate cultures and facilitate innovative procedures. Technology can provide the information. But it is processed, analyzed or acted upon, the right information must first be made available at the right time to the systems and individuals who need it—to work on the same and avoid the risk on time. Before an enterprise can attempt to manage risk on an enterprise-wide basis, it first must collect and communicate all necessary information relating to those risks. Today, technology makes it possible to effectively communicate information—across desks, across departments, and across globe. This technology is called data aggregation.

How much risk one is taking : This question is so simple—and yet so profound. ERM supports right answer to this. In the past, organizations would look at Profit & Loss statement to answer the question. Volatile profits meant high risk. But profit & loss is a retrospective and historic indicator of risk. Indeed, for many risks, profit & loss statement may reveal little or no information. In order to manage risks, organizations need to be able to measure those risks prospectively. What is measured well is better managed. Organizations are addressing this challenge with statistical risk measures. For market risk, value at risk is being used. For credit exposure, measures such as expected exposure or maximum exposure are being used. Trained specially, CMAs could play an important role in this area with professional expertise for prudent enterprise-wide risk management strategy.

Enterprise-Wide Comprehensive Risk Management

Besides the increase in the variety of risks, banks are now beginning to focus on their inter-linkages. This helps achieve a more comprehensive risk management framework upgrading the same to suit the changing environment. ERM (Enterprise Risk Management) helps banks to move away from managing risk in isolation (i.e. individual silo system) making it proactive, systematic and spans across the entire organization achieving 'risk integration across

Contd. to Page 678

Compliance Governance : A Hybrid Model

Satya Narayan Maheshwari*

Introduction

Over the last decade the need for effective compliance at financial services and banking companies has been growing stronger than ever. The ever increasing regulations, increasing complexities involved in handling financial crimes, complex products, and higher geographical reaches are contributing to requirement for more effective compliance function in order to avoid actions that could lead to damaged reputation and large penalties. Compliance is one of the core areas on which banks are increasing their focus on efforts to address existing and potential risks.

The governance of compliance function has an important bearing on its effectiveness and efficiency. The compliance function, being intricately linked with business, tends to follow similar governance model to that of business operating model. Such Governance of compliance function over time may need evaluation and review in view of increasing regulations and complexities involved.

In this paper we discuss the hybrid governance model for compliance, design principles for defining governance model, and detailed case study of the subject.

Compliance Governance : A Hybrid Model

In an ideal scenario a completely centralized compliance function would be the most effective one. However, with most financial services and banks following growth oriented diversified business model and the fact that the compliance and business are intricately linked, it may seem challenging at times to go for centralised governance model for the compliance function. Hence a hybrid model of centralization of strategy and investment and a federal flavor with a COE model would potentially be a viable option for banks following a diversified business model.

With ever increasing operational complexities and regulations a hybrid model comprising of Centers of Excellence for key areas will ensure :

- Shared best practices
- Innovations
- Standardization of processes
- Harmoniised workforce.

This model capitalises on the knowledge of best talents in the area within the organization across the globe for this function.

Case in Point

A leading bank with its headquarters in Europe has been following decentralised model for compliance function, aligned to the business operating model. However, this model has proved to be extremely challenging to sustain, as it led to an unacceptable level of variances in performances and higher cost.

The current operating model led to localised processes and procedures across business entities. The geographic entities were following their own processes to cater to local needs and updates to IT system. The compliance processes such as 'Customer due diligence' were not standardised across business entities.

There was no formal system for knowledge management. Localised systems resulted in high costs as this involved duplication of effort due to absence of formal Knowledge Management System at global level.

There was lack of awareness among global users on the various product features. Further, there was no comprehensive monitoring system. Quite a few issues were due to absence of appropriate governance for the compliance function of the bank.

Overall the problem areas can be summarised as :

- The historical decentralised model of governance for IT, KYC (Know Your Customer) and FEC (Financial Economic Crimes) has resulted in unacceptable variance in the performance of standard core processes and tools such as those used for FEC screening and monitoring.
- There is lack of clarity on how far the mandate extends vertically into the operations of stand-alone installations of the systems as to who has control over local system strategy, budget, configuration, and version control. The current policy on IT asset ownership does not adequately address ownership of multiple systems.

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• There is also a lack of coordination across the bank for related systems development resulting in likely duplication, waste of capital, and lack of connectivity.

It became imperative that the bank moves from a high cost inconsistent compliance operation to a optimized and customer centric model. The primary objective of the engagement is to set a new governance model which will specify the decision rights and accountability framework for the KYC-FEC compliance function to encourage enterprise desirable behaviors.

Design principles for defining governance model

Michael Treacy and Fred Wiersema described in their "Value Disciplines" model that any company must choose one of the three value disciplines and act upon it consistently and vigorously. This forms the business strategy of the organization. The three value disciplines are :

• ***Operational Excellence :*** Organizations with superb operations and execution skills by providing a reasonable quality at a very low price. The focus is on efficiency, streamlining operations, supply chain management, no-frills, volume counts etc.

• ***Product Leadership*** *:* Organization with very strong innovation and brand marketing and operating in dynamic markets. The focus is on development, innovation, design, time to market, high margins in a short time frame etc.

• ***Customer Intimacy*** *:* Organizations excel in customer attention and customer service. They tailor their products to individual customers. Focus is on CRM, on time delivery, customer expectations, life-time value concepts, reliability, proximity to the customer etc.

From a compliance perspective, operational excellence and customer centricity are the key drivers. Hence it is critical to understand the operating model it assumes. For each 'value discipline' or business strategy, a corresponding operating model based on its unique role is pegged. The following design principles for the bank could be drawn upon from these two key drivers :

• Customer is the single common link with each of the system/process areas.

• The bank needs :

  – global customer view

  – consistent approach to obtaining, storing and retrieving customer information.

• Standardization of systems and processes to reduce variability and increase efficiency, reducing risk and operating cost.

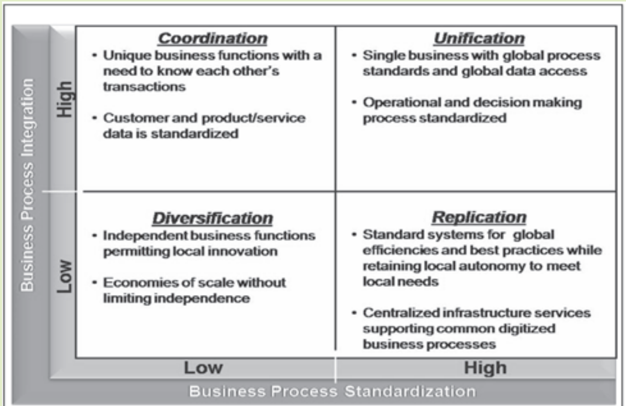
• Common systems architecture that facilitates product, service and geographic differences.

• Leverage and reuse assets, best practices and have better knowledge management.

Operating Model Framework

An operating model is the targeted level of business process integration and standardization for delivering goods and services to customers. To understand the current operating model in detail, the MIT CISR framework helps us in deriving four types of operating models based on the extent of business process standardization and business process integration.

Each type of operating model (depicted in picture) will have unique system capabilities and also gives an indication of the indicative governance mechanisms as per best practices. Once the operating model is determined, the model will help us to drive towards understanding the mechanisms in the better way.

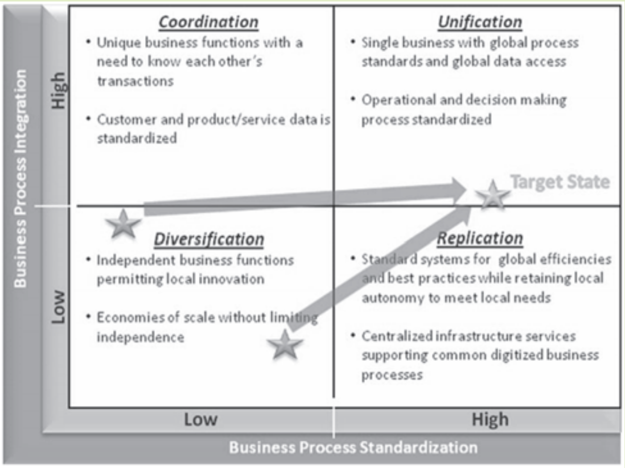


Source: MIT CISR Operating Model Framework; TCS is a research patron of MIT CISR

Hybrid Governance Model

As depicted in the above picture the current model of the bank was aligned 'coordination' for some components and 'diversification' for other components. For example, for CDD for retail the bank had localised processes (Diversified Model), but 'customer activity monitoring' for specific business line followed 'Coordinated Model'. As the bank followed diversified business model, the compliance function was in sync with the same.

Based of this analytical framework and design principles agreed upon, the option of hybrid model of 'centralised with replication' (COE) model was recommended.



The implications of this model are :

● ***Unification :*** Strong centralized governance (Senior Executive Committee/Board to provide funding and decide priorities across all verticals; Performance incentives based on organization level performance)

● ***Replication :*** Semi Federal governance mechanism (COEs, Centralized process design teams, process owners/experts/ power users).

The recommended model moots a central governance board for KYC-FEC with Centers of Excellence for individual components reporting to it. This board will report to the bank's board. The various decision domains, their responsibility and objectives are as depicted in the picture below :

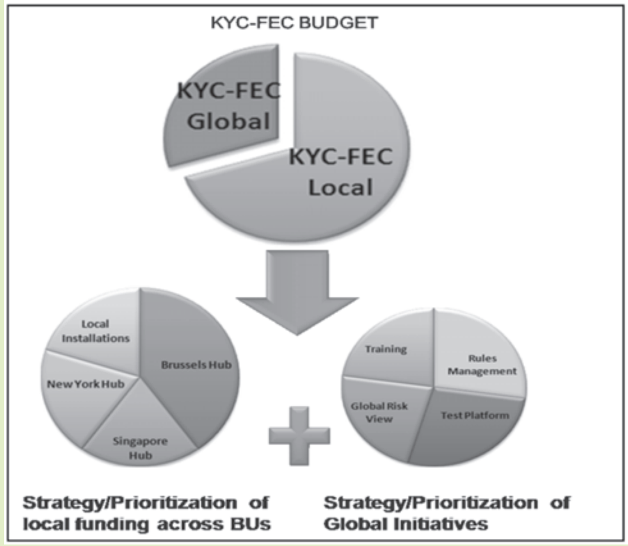
Decision Domain	Responsible	Objective
KYC-FEC Governance principles	KYC-FEC Board	Define and implement the *unified* principles of KYC-FEC Compliance
KYC-FEC System investment and prioritization	KYC-FEC Board	Decisions on Investments and prioritization of KYC-FEC initiatives
KYC-FEC System Strategy & Innovation	KYC-FEC Board	Strategy to achieve desired process and system standardization and integration
KYC-FEC System needs	CoEs	Specify the needs for purchased or internally developed systems
Continuous KYC-FEC System/ process improvement	CoEs	Ongoing improvement in system capabilities and process

The central board would have its own budget and control over investments related KYC-FEC governance. It will ensure a global Strategy and prioritization of investment across Geography and Business lines.

The key features of Investment Governance (KYC-FEC Board) are :

- The board drives all KYC-FEC investment across organization.
- Provides funding and decide priorities for investments across all BUs.
- Asset Ownership is centralized.

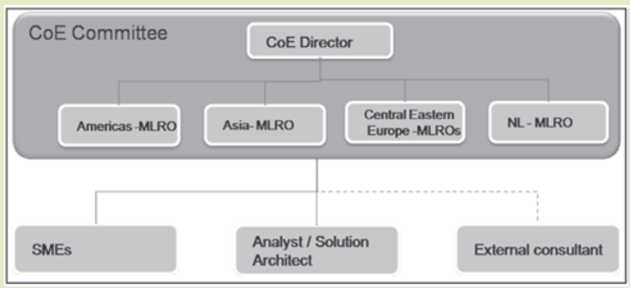
- KYC-FEC budget will have a global and a local component as illustrated in the picture below:



- Global Budget Component: Investment for rolling out systems/changes globally.
- Local Budget Component: Investment specific to a BU/region is prioritized centrally across BUs.
- Global budget/costs are charged back to the individual BUs.
- COEs will provide input for Investment decisions for global and local components.

The center of excellence for different components like KYC, CDD, CRM etc were recommended.

The organisation structure of trypical COE will be as depicted below :



COE is a virtual organization cutting across BUs/ Geographies drawing upon the best talents in the area across the globe. The core functions of the COEs will be service delivery (based on its mandate as depicted in the picture below), continuous improvement, and innovation.

The rationale for recommendation of this model is :

- This is based on global best practice for governance components of Compliance Function of banks. There are global reference points and the bank can leverage industry best practices in the area.

- Centralised governance board for compliance function with its own budget will be effective in adressing the challenges the bank is facing.
- COEs will be centrally governed with a well-identified structure having its own agenda for the organization as a whole.
- This is globally accepted model for standardization and replication and is in alignment with bank's strategic intent to industrialize. It will help in having globally standardized processes with local customization where necessary.
- It is blend of top-down (shared vision and goals) and bottom up approach (continuous improvement) to increase operational excellence and drive shareholder value, by leveraging industrialization and knowledge management. This will help bring in competitive advantage.
- COE team consists of a "critical mass" of highly knowledgeable experts in the field, drawing upon global capabilities leading to higher employee satisfaction.
- In COE Model, knowledge management system is key enabler and support system for operation of COE drawing upon global best practices, sharing and learning and improving across the globe avoiding duplication of effort in reinventing wheel.
- COE has a dynamic role in the innovation system (adding value to processes, policies, products, services, work systems, business models etc).

Conclusion

This paper elaborated a hybrid governance model with a detailed case study. The case study elaborated analysis of various factors to be considered and usage of appropriate frameworks to arrive at the best fit model. The recommended hybrid model comprising of Centralised and Replication (COE) will ensure transition from a high cost, inconsistent compliance operations to a optimized and customer centric model. The federal flavor with COE will help address the challenges such transformation poses while moving from existing diversified model to the compliance governance.

The recommended hybrid governance model (centralized with COEs) will help

- Reduce compliance risk.
- Better operational efficiency due to
  - Standardization of processes
  - Leveraging of global best practices
  - Better knowledge management, reuse of intellectual assets.

Organizations should not only ensure compliance of existing regulatory requirements but should also prepare for future as the regulation may get stricter to address potential risks. Committed organisations should comply with best practices and highest standards of governance—not merely regulations. Centralised Governance model with COEs is the best fit model to achieve this. ❒

Contd. from Page 674

the firm and risk aggregation across the group both in the specific risk areas as well as across the risks. Banks would, hence, be required to allocate significant resources towards this endeavour. CMAs can play significant role in providing meaningful MIS support, cost effective adoption of technology in ERM implementation and in standardization, measurement and reporting systems.

Conclusion

Risk management is always going to be a rich field of endeavour, and any attempt to codify 'best practice' or any other set of standards risks being left behind by events in the marketplace (as seen with the collapse of giants in financial services in the recent past) . However, the industry still has a number of significant challenges to overcome, and it is entirely understandable that supervisors will wish to set rules for establishing minimum capital adequacy standards, however flawed these may be. Having devoted substantial resources to strengthening risk processes and systems to comply with Basel II and other regulations, banks should be looking for ways to use this investment to enhance their strategic decision-making. Risk management in financial institutions remains an important area for Cost Management Accountants in terms of scope for professional contribution. Risk management is a continuously evolving mix of science and art. Risk itself is not bad, but risk that is misplaced, mismanaged, misunderstood, or unintended is bad. Each institution needs to assess which method best suits its objectives, its business, its view of the world and its pockets. A clear distinction should be made between risk management and risk taking. Risk management oversees and ensures the integrity of the process with which risks are taken. To maintain the objectivity, risk management cannot be a part of the risk taking process. Individuals who manage risk need to be completely independent from individuals who are responsible for taking risk. If Management Accountants can excel in cost audit, strategic cost management, management audit and in being a vital part of the top management, the scope in the area of risk management is not only enormous but it remains untapped. ❒

Risk Management in Banking Sector : An Overview

Arindam Banerjee*

In this era of Liberalization, Privatization and Globalization where competition is becoming a buzzword, the banking sector in emerging economies is witnessing a radical change. Due to the fast changing financial environment, the banking sector is exposed to a number of risks. The present article begins with an introduction to the commercial banking in Indian Scenario and further tries to locate the risk management areas in Banking Sector. The article further highlights the increasing role of Cost and Management Accountants (CMAs) in commercial banks in India so to contribute towards risk management functions to increase its efficiency and growth.

Introduction

The era 90s saw very significant policy changes introduced in the sphere of financial sector, foreign trade, public sector and social sector, The year 1991 was the one when the process of liberalization and globalization hit the Indian economy and pushed our country to break open the "Inward Looking" policy when the emphasis was accorded to protectionism and import substitution. Since 1991,India has proved to be a key player in the world. Our country's interaction has increased with many economies ties, political harmony, tourism trade and services more significantly in the area of investment.

The financial sector, especially the banking sector, is one of the emerging sectors in Indian Economy. From 1991, when the banking sector ushered to the era of reforms the banks has been progressing towards global integration of financial services which calls for greater efficiency to face competition.

To meet with the increased competition, all the banks are striving towards introducing new products to the customers with advancement of technology and adopting strategies to necessitate changes in organizational structure of the bank and reorientation of policy, procedure and system.

Financial Structure

The Indian Financial System comprises of the flowing institutions:

A. Commercial Banks

- i. Public Sector Banks
- ii. Private Sector Banks
- iii. Foreign Banks
- iv. Cooperative Banks
  - a. Urban Cooperative bank
  - b. State Cooperative Bank
  - c. Central Cooperative Bank

B. Financial Institutions

- i. All Indian Financial Institutions
- ii. State Financial Institutions
- iii. State Industrial Development Corporation

C. Non Banking Financial Companies (NBFC)

D. Capital Market Intermediaries

In commercial Banking sector about 90% of the country's banking sector is under state control while balance comprises of private and foreign banks. In 1969 the government arranged for nationalization of 14 scheduled commercial banks in order to expand the branch network followed by 6 more in 1980.

RBI (Reserve Bank of India) is the central bank of India and bankers to banks—whether it is commercial, rural or cooperative. It was established in 1935 and is governed by RBI Act.

Different types of Risk in Banking Sector

The Indian Banking industry is making great advancement in terms of quality, expansion, diversification and updating technology where a need is felt to emphasize on a strong and special control system with an extra concern for risk involved in the business.

Risk can be defined as an exposure to a transaction with loss, which occurs with some probability and which can be expected, measured and minimized. Managing financial risk systematically and professionally has become an important task for the managers. Increasing global competition, increasing deregulation, introduction of new financial innovative products and delivery channels have pushed risk management to the forefront of today's financial landscape. It is very important how the managers gauge the risks and take appropriate position to minimize the risks key to success for the organization.

The various types of risks faced by the banks are classified as below :

- Financial Risks
- Non Financial Risks

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Financial Risks

Credit Risks : Credit Risks can be defined as the risks associated with the possibility of the borrowers defaulting in their payment of loans taken by them from the bank. In the bank's portfolio losses can arise due to outside defaults because of inability or unwillingness of the customer or the counter-party to meet commitments, losses may also result from reduction in portfolio value arising from actual or perceived deterioration in credit quality. Thus credit risk can be defined as possibility of losses associated with decrease in credit quality of the borrowers.

Market Risks : Market Risk can be defined as the risk of incurring losses associated with the movement of market price on all positions held by the banks.

Forex risk is the risk of loss that arises due to bank suffering on account of adverse exchange rate movement against uncovered position in foreign currency.

Liquidity risk of the bank may arise due to the funding of long-term assets with short-term sources or deposits. The changes in the interest rate can significantly affect the Net Interest Income (NII).

The risk of adverse impact of NII due to variation in interest rate is called interest rate risk.

Thus, it can be observed from above that market risk can be further subdivided into :

- Interest Rate Risk
- Forex Risk
- Liquidity Risk
- Hedging Risk.

Non-Financial Risk

Non Financial Risk can be segregated into: Operational Risk, Strategic Risk, Funding Risk, Political Risk, Legal Risk.

Operational Risk is the risk of losses arising due to the failure of internal system, process and people.

Strategic Risk is defined as the risk associated with failure to implement appropriate business plans, strategies, decisions with regarding to the allocation for resources or adaptability of the business in this age of dynamic changes in environment. The political and legal risks arise due to rapid changes in the political and legal environment that the banks are exposed to.

What is Risk Management?

Risk Management is one of the essential functions of any banking service. It should be the central plan for any bank's strategic management.

Risk Management may be defined as the process whereby the bank methodically addresses the risk attaching to their activities with the goal of achieving sustained benefits within each activity and across the portfolios of all activities.

The focus of good risk management is on identifying and treatment of the risks and add maximum sustainable value to all activities of the organization. It increases the probability of success and reduces the probability of failures to achieve the bank's goals and objectives. Risk management should be a continuous and developing process which runs through the bank's strategy and implementation of such strategy. It should address methodically all the risks surrounding the organization's activities—past, present as well as future. It must translate strategy into tactical and operational objectives assigning responsibility throughout the organization with each manager and employee responsible for management of risk as a part of their job description. It must be integrated into the culture of the organization with an effective policy and programme led by senior management and should support accountability, and performance management and thus reward operational efficiency at all levels.

Thus, the basic objective of risk management is to the stakeholders' value by maximizing the profits and optimizing the capital funds for ensuring long-term solvency of the banking organization.

How to manage risk in Bank?

A proper risk management process should be employed in the banking organization to properly manage the risks involved so as to achieve and fulfil organizational goals and objectives.

The various steps involved in risk management process can be summarized as :

- Risk Identification
- Risk Description
- Risk Quantification/Measurement
- Risk Control
- Monitoring and Review.

Step 1 : *Risk Identification*

Risk Identification sets out to identify the organization's exposure to uncertainty. It should be approached in a more systematic and methodical manner to ensure that all the significant activities in the banking organization have been identified and all the risks flowing from such activities are defined. All the associated volatility are identified and categorized properly.

The risk identification involves :

- Understanding the nature of various kinds of risk

- the circumstances that results in a situation to become a risky situation
- Various causes due to which the risk can arise.

Step 2 : ***Risk Description***

The objective of risk description is to display the identified risk in a structured format, say, by using a table. The use of well-designed structure is necessary to ensure comprehensive risk identification, assessment and description process. Some of the variables that can be used in risk description are: Name of the risk, Scope of the risk, Nature of risk, Risk tolerance etc.

Step 3 : ***Risk Quantification/Measurement***

Though the exact measurement of the risk is not possible but the level of the risk can be determined by different risk rating models. Risk Quantification is a very important step in risk management process as it is an assessment of degree of risk which a particular activity or transaction is exposed to.

Step 4 : ***Risk Control***

Risk control is the step where bank can take various measures to control risks associated with different activities :

- Securitization and Reconstruction
- Diversification of Business
- Insurance and Hedging
- Fixation of Exposure Ceiling

Step 5 : ***Risk Monitoring and Review***

Effective risk management process requires a monitoring and review structure to ensure that risks are properly identified and assessed and that proper control and response are in place. The monitoring process should provide assurance that there are appropriate controls in place for the banking organization's activities and that the procedures are understood and followed.

In risk monitoring and review the bankers have to fix up the parameters on which the transactions have to be tested to be sure that there is no risk in the viable existence in the financial units or investment of the banks.

Thus an effective and efficient risk management policy in the bank should ensure that it integrates the various tools and techniques for use in various stages of business process and also sets out responsibility of risk management throughout the organization. In this regard role of Board of Directors assumes great importance for determining the strategic direction of the bank and for creating the environment and the structure if risk management is to operate efficiently and effectively.

6. ***Role of Cost and Management Accountants in Commercial Banks in Managing Risks***

Cost and Management Accountants play a very vital and important role in every business concern. The services of Cost and Management Accountants (CMAs) are increasingly becoming important for the Industries, Banking sectors, Financial Services etc in this era of globalization.

CMAs establish, coordinate, as well as maintain an integrated plan for control of operations. He advises the company regarding various financing, investment and dividend decisions so as to maximize the wealth of the shareholders.

He is very vital to strategic resource planning and allocation particularly to sectors highlighted by growth and opportunity.

Similarly, CMAs have a greater role to play in banking sectors in India. Gone are the days where his task was limited to preparation of financial statement and ascertainment of the costs. With the world becoming a global village a CMA's task has become manifold. He is now a key decision making manager in the organization whose task a includes wide range from cost control, cost management as well as strategizing cost to financial planning in the decision making process of the organization.

Though the area of functioning of CMAs are not restricted to any specific areas because of their vast knowledge and skills some of the areas where CMAs can make significant contribution in area of risk management in banking sectors are highlighted :

- ***Internal Audit :*** Cost and Management Accountant should be key member of internal audit team of the bank. As a part of the audit team his key responsibility should be to

1. To focus on the internal audit work on the significant risks identified by management and auditing the risk management processes across the organization.
2. Providing assurance on the management of risk.
3. Providing active support and involvement in risk management process.
4. Facilitating risk identification/assessment and coordinating risk reporting to the board, audit committee etc.

- **Working Capital Finance :** Majority of the advances given by the bank includes working capital finance. Every bank does have a separate credit department, which is busy sanctioning working capital finance. CMAs can play a very vital role in this regard determining the amount of working capital finance after taking into consideration the various risks involved in taking the decision.

Apart from the above, CMAs can contribute towards stock audit, project appraisal, valuation of assets etc in banking sector.

In the above areas, CMAs should be capable to identify the risks involved in each area with the help of their knowledge and skills in risk management, investment control etc. and guide the management in respect of credit risk management.

Conclusion

Risk Management should be embedded within the organization through strategy and budget process. The resources required to implement the organization's risk management policy should be established at each level of management and within each business unit. Banking industry—being exposed to different types of risk like credit, forex, interest risk which are affecting its profitability and financial health—should implement comprehensive risk management framework and the result in wide ranging effect on bank's information technology, process, system, people and risk management and finance functions.

Thus there should be proper coordination and implementation of risk management process in the banks so as to increase the efficiency, growth and profitability of the banking organization. ❐

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THE INSTITUTE OF COST AND WORKS ACCOUNTANTS OF INDIA

12, Sudder Street, Kolkata - 700 016

NOTIFICATION

Cancellation of Registration under Regulation 25(1) of CWA Act, 1959
Registration Numbers Cancelled
For December-2011 Examination

UPTO

ERS/002802, NRS/004400 (except 4033, 4047, 4049-4105), 4695-4700

SRS/009075, WRS/006806, RSW/077893, RAF/005855

RE-REGISTRATION

The students whose Registration Numbers have been cancelled (inclusive of the students registered upto 30th June 2004) as above but desire to take the Institute's Examination in December-2011 must apply for **DE-NOVO** Registration and on being Registered DE-NOVO, **Exemption** from individual subject(s) at Intermediate/Final Examination of the Institute secured under their former Registration, if any, will be treated as per prevalent Rules.

For **DE-NOVO** Registration, a candidate shall have to apply to Director of Studies in prescribed Form (which can be had either from the Institute's H.Q. at Kolkata or from the concerned Regional Offices on payment of Rs. 5/-) along with a remittance of Rs. 2000/- only as Registration Fee through Demand Draft drawn in favour of THE ICWA OF INDIA, payable at Kolkata.

Date : 21st June, 2011

ARNAB CHAKRABORTY
DIRECTOR OF STUDIES

Business Process Excellence — Synergies of Six Sigma and ERP

U. Lakshmana Rao*

This article is aimed at highlighting the synergies of combined application of Six Sigma (6σ) and Enterprise Resource Planning (ERP) in achieving the Business Process Excellence.
Six Sigma is a Business Process Management Strategy aimed at improving the quality of a business process whereas ERP is a Business Process Management System aimed at integrating all the business processes of an enterprise. Both strategy (6σ) and system (ERP) largely deal with data. Six Sigma leverages the data for statistical analysis to identify various alternative solutions to improve the business process, whereas ERP accesses the data from the enterprise system to enable accurate and timely statistical analysis.
Organizations today are striving to combat competition to improve their market share, achieve better customer satisfaction and, at the same time, trying to maximize the Return on Investment (ROI). Majority of the honchos believes that robust business processes make their product or service globally competitive. Using Six Sigma in conjunction with Enterprise Resource Planning (ERP) alleviates implementing the best business practices with an objective of achieving Excellence in Business Processes.

What is Business Process?

"A business process is a structured set of business activities designed to deliver a product or service to meet the expectations of the customer and stakeholders involved in the business whether directly or indirectly."

A typical business process is depicted below, popularly known as SIPOC diagram indicating Suppliers, Inputs, Process, Outputs and Customers.

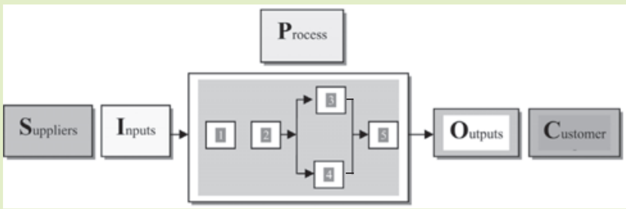

Fig. 1: Typical Business Process Flow

What is Business Process Excellence (BPE)?

"Business Process Excellence is a state of designing or delivering a business process effectively and efficiently or excelling (performing) a business activity (product or service) in an outstanding manner with a superior quality to meet the expectations of the customers and stakeholders by adding value at each level.**"**

What is the need for Business Process and why should it be Excellent?

A business process is required to perform the business activities in a systematic manner and the business process should be excellent to deliver outstanding and value added results (i.e., product or service).

What are the outcomes of Business Process Excellence?

- Optimum Utilization of Resources
- Conservation of Natural Resources
- Improves Productivity
- Reduces Lead Time of Activities
- Faster Service look-ups
- Lowers the Cost of the Product or Service
- Lowers the business risk
- Improves Profitability and Return on Investment
- Maximizes Shareholders' Wealth
- Greater customer and stakeholders' satisfaction.

What is Six Sigma (6σ)?

"Six Sigma is a Business Process Management Strategy aimed at improving the quality of a business process by minimizing defects". Six Sigma allows 3.4 Defects Per Million Opportunities (DPMO) in each product or service related business process transaction".

Sigma (σ) is a Greek letter used to represent Standard Deviation (SD) in Statistics. 6σ means 6 (six) **Standard Deviations** from the **Mean** (the target**)** in statistical lingo.

Six Sigma, being a statistical tool, largely depends on **data** as it involves many statistical calculations.

Where there is an output, there is a process. If there is a process, there will be a variation in performance. When there is variation in performance the process is subjected to Six Sigma. It is more of measuring variations due to defects and identifying the cause-and-effect relationship between the two.

Six Sigma variance based thinking believes that 'a

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customer always looks at **variance**, as **mean** is meaningless'

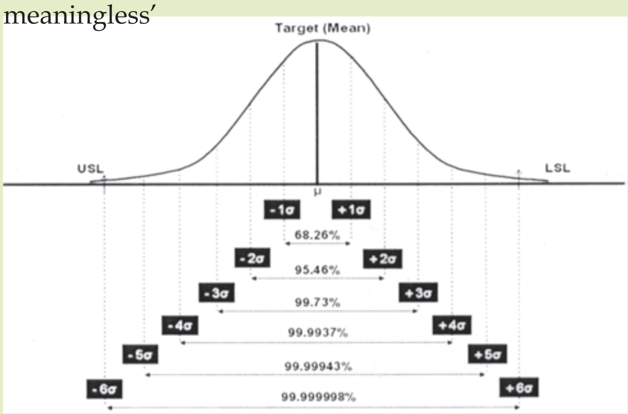

Fig. 2 : Six Sigma Level

Six Sigma comprises of various methods that help in increasing the effectiveness and efficiency of a business process. The two most commonly used Six Sigma methodologies include **D**efine, **M**easure, **A**nalyze, **I**mprove and **C**ontrol (DMAIC), and **D**efine, **M**easure, **A**nalyze, **D**esign, and **V**erify (DMADV). The former is applied in *existing* business process; the latter is applied for *new* projects or process development. In DMAIC, improvements are made in a business process for eliminating or reducing defects whereas, in DMADV, an appropriate business model is designed that helps in meeting customer require-ments. In DMAIC, control systems are put in place to keep a check on future performance of a business process. In DMADV, the suggested business model is put through simulation tests for verifying efficacy in meeting customer needs and specifications. But both are aimed at minimizing the defects to 3.4 DPMO.

What is ERP?

"An ERP (Enterprise Resource Planning) is an integrated Business Process Management System that integrates all business processes, resources, functions and departments in an organization and facilitates automatic transfer of data between the above."

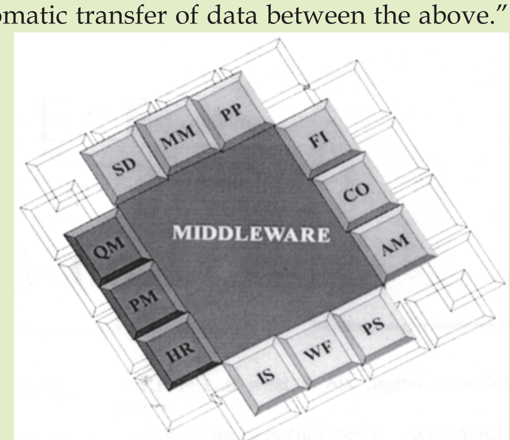

Fig. 3 : Integrated ERP Modules

An enterprise wide system is an off-the-shelf package that provides an integrated suite of applications which provide transaction processing and management information systems for the common core of business processes found in financial management, material management, human resource management, manufacturing, and sales and distribution.

Since there is an integration of different business processes and automatic transfer of data between these businesses processes, ERP can be called Computerized Business Process Management System with an inbuilt warehouse for **data** storage and retrieval.

Six Sigma and ERP

From the above definitions of ERP and Six Sigma the common dynamic is **"data"**. The former '*stores and retrieves the data*' and the latter '*uses the data*' for statistical analysis. This does not mean Six Sigma depends on ERP. The statistical analysis is again stored in the form of data in ERP and retrieved for decision making.

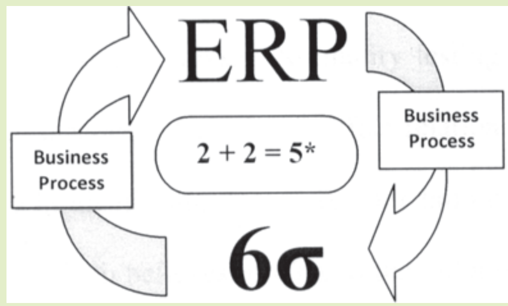

Fig. 4 : Synergy Effect of ERP and Six Sigma
**Positive synergy is sometimes called 2+2=5*

Having discussed about what ERP and Six Sigma is, now let us look at the synergies of deploying both in an existing business process (not new). Accordingly, the following discussion is focused on DMAIC methodology and ERP.

Use of Six Sigma during implementation of ERP

The two common problems generally noticed during ERP implementation are customer require-ments gathering, project scheduling, and project cost estimation. By deploying six sigma tool 'voice of customer' the client requirement can be collected through surveys, group discussions and interviews to plot them in a 'voice of customer table'. Voice of Customer (VOC) table addresses the issues what exactly is required by the client, when it is required, and what price the client is willing to pay etc. This resolves the issues during requirements gathering phase and reduces the gap between the actual requirement of the client and ERP imple-mentation consultants. The synergy from this will be faster implementation and lesser post-implementation issues.

As mentioned above, the second common issue during ERP implementation is project scheduling and cost estimation. The ERP implementation team can collect some past data of the client related to other processes, experiences of previous projects' implementation. Such data can be analyzed by using six sigma tools i.e., Normality Testing, Cause and Effect Relationship (Fishbone Diagram), Pareto Analysis, and Process Map Analysis. Normality, testing helps in identifying variances of previous projects and existing processes. 'Cause and Effect relationship' (Fishbone Diagram) of the previous failures, if any, may help in identifying the reasons for failure or success of previous projects. Pareto analysis (80 : 20 principle which believes in 80% of the failures are caused from 20% of the causes) helps in identifying the major reasons for previous failures. 'Process Map Analysis' helps in identifying the cycle time (process time + delay time = cycle time) for previous activities. All these may give a fair idea of allowance to be considered in the ERP project schedule and costs related thereto. The synergy here is prefect project implementation schedule which results in reduction of implementation time and costs associated therewith.

Use of Six Sigma in post-implementation of ERP

The following table provides a broad idea about the synergies of combined use of Six Sigma and ERP :

Six Sigma Phase	Six Sigma Approach	ERP Approach	Synergy
Define (D)	Pain areas of the business process are identified and defined for improvement using tools viz., SIPOC, Voice of Customer (VOC) Table, Team Charter, Process Mapping etc.	Feedback received from Customer Relationship Management (CRM) Module, web, SMS based surveys can be a great input to prepare VOC Table.	Real time accurate feedback available for identifying the pain areas of the business process and helps in defining the problem clearly and quickly.
Measure (M)	Performance parameters are defined and established to measure the performance using tools viz., Process Map, Control Charts and Pareto Chart etc. Measurement system is validated for the pain areas identified in Define Phase.	As ERP is an integrated business process management system, established performance parameters (standards) are stored automatically and can be retrieved anytime.	Established performance standards are available in the ERP system, can be accessed on real time basis; measurement system can be quickly established for current process, also simplifies the validation of data.
Analyze (A)	The gap between current and desired levels of performance are analyzed by using the data collected during the Measure Phase using tools viz., Cause & Effect diagram, correlation, regression analysis, and flow diagrams The gap between current and desired state is also calculated in financial terms.	Data collected during Define phase and Measure phase are stored in the ERP system to generate analytical reports. Facilitates access to historical data archiving for future analysis.	Correlation, regression analysis, causes & effect diagrams can be analyzed on real-time basis which reduces analysis time significantly. Historical trend analysis provides a great input to simulate the future business processes.
Improve (I)	Having defined the problem, measured the performance gap and analyzed the reason for such gap, possible alternative solutions are devised and best possible solution is identified. The Performance Improvement plan is designed and implemented to achieve the desired state of process improvement.	Facilitates the storage of analysis made in the earlier phase, alternatives solutions are available in the system. Performance improvement plans available for the process owners. Progresses of improvements are made available from time to time.	Facilitates in selecting best alternative solution out of the various alternatives available. This makes the process improvement more scientific and robust. Performance improvement in the process can be tracked by the process owners on a real-time basis and will be a great input to the control phase.
Control (C)	In this final step process improvement plans are documented and knowledge is transferred to stakeholders to keep the improved process under control. Tools viz., Quality Control process charts, control charts, standardization of practices, Poka Yoke (mistake proofing) etc.	Control charts, Standardization of Practices are available within the integrated business process management system. Historical data of various control measures established and initiated are available as ready reference.	Control measures can be established on real-time basis. System alerts can be inbuilt in the process where the process owner can be alerted immediately when the process is not performing within the defined limits.

Epilogue

Using Six Sigma and ERP is not a destination for Business Process Excellence. It is a journey towards continuous improvement process. It may be superlative if the organizations make Six Sigma and ERP as part-and-parcel of their continual improvement plan (Kaizen). To achieve maximum synergies, organizations must ensure managability of organizational changes by inculcating such culture that requires acceptability of Six Sigma and ERP. Last but not the least, drive towards achieving Business Process Excellence should maintain a balance between 'Process Efficiency' and 'Business Agility'.

References

- Author's practical experience as a SAP FICO Consultant and other ERPs
- Author's practical experience as designated CFO of Six Sigma projects
- Author's practical experience in the fields of Finance, Accounts, Controlling, and Business Analytics
- www.isixsigma.com
- www.searchmanufacturingerp.com

REQUEST FOR COMMENTS

The Quality Review Board of the Institute, in its meeting held on 4th June 2011, has approved the release of **Exposure Draft of Guidance Manual for Audit Quality.** The proposed manual may be modified in light of comments/suggestions received.

The members are requested to forward their **comments / views / suggestions** on the same **preferably by email at** ***qrb@icwai.org***, latest by August 16th, 2011.

Comments can also be mailed to the following address :

The Secretary,
Quality Review Board of ICWAI,
The Institute of Cost and Works Accountants of India,
ICWAI Bhawan, 3rd Floor,
3, Lodi Road, Institutional Area,
New Delhi - 110003

Copies of this Exposure Draft may be downloaded from the QRB website at ***http://www.qrbicawai.in***

REQUEST FOR COMMENTS

The Central Council of the Institute has approved the release of **Exposure Draft of Generally Accepted Cost Accounting Principles (GACAP) Document** as recommended by the Cost Accounting Standards Board (CASB), the standard-setting body of the Institute on July 21, 2011. The proposed document may be modified in light of comments received before being issued in the final form.

Please submit your views/comments/suggestions on the proposed document, **preferably by email,** latest by **September 5, 2011**.

Comments should be addressed to :

The Secretary,
Cost Accounting Standards Board,
The Institute of Cost and Works Accountants of India,
ICWAI Bhawan, 3rd Floor,
3, Lodi Road, Institutional Area,
New Delhi – 110003

Emailed responses should be sent to : **casb@icwai.org**

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International Law of the Sea and Indirect taxation — Bounty of Nature and Problems of the Law

P. Ravindran*

The sea, washing the equator and the poles, offers its perilous aid, and the power and empire that follow it... ''Beware of me,'' it says, ''but if you can hold me, I am the key to all the lands.'' – Ralph Waldo Emerson

The Sea has always fascinated mankind. It is the determiner of the prosperity of world trade and indeed the whole world. Seventy percent of world trade goes over the seas. In the case of India it is more than ninety percent. Countries have traditionally tried to exercise control over the seas. Big empires and powers in world history have rarely survived for long without simultaneously being maritime powers as well. The discovery of oil and natural gas and other mineral riches in the ocean bed, apart from the millennia of fishing, has compounded the politics of the sea and heightened the desires among countries to benefit from the resources of the vast and seemingly inexhaustible waters and the fathomless beds of the oceans. Therefore, it is no wonder that there should be unrelenting rivalry in the world regarding sea control and over access to the sea lanes. Many disputes continue to this day and have the potential to trigger calamitous wars. Nevertheless, it is to the credit of the United Nations that a broadly-accepted regime of rights and duties and framework arrangements has been put in place in the form of an International Law of the sea. Many conferences and meetings among countries over the past decades culminated in the 'landmark' treaty of the UN Convention on the Law of the Sea, 1982, to which India is a signatory.

The objectives of the law of the sea thus adopted could be summarized as :

1. Settlement of the law of the sea will contribute to international peace and stability.

2. It will safeguard the uses of the sea as the common heritage of mankind, consistent with the principles of justice and equal rights, historical patterns and the particular needs of the developing countries—both coastal and land-locked.

3. Promoting the peaceful uses of the sea for a just and equitable international order.

By virtue of the UN Convention on the Law of the Sea, 1982, India legally became entitled to control and jurisdiction over the following: The basic Indian law on this subject is the Territorial Waters, Continental Shelf, the Exclusive Economic Zone and Other Maritime Zones Act, 1976, which empowers the Central Government to extend Indian enactments to the maritime zones :

1. Territorial waters of the sea
2. Contiguous Zone in the sea
3. Continental Shelf of the sea.
4. Exclusive Economic Zone in the sea

They are briefly explained as :

The Territorial waters

The limit of the territorial waters is the line every point of which is at a distance of ***twelve nautical miles*** from the nearest point of the appropriate baseline in the coast. India exercises full and unlimited sovereignty over this extent of the sea. Right of foreign ships to innocent passage through these waters subject to regulations by India is the exception.

The Contiguous Zone

The contiguous zone of India is an area beyond and adjacent to the territorial waters—the limit of the contiguous zone is the line every point of which is at a distance ***of twenty-four nautical miles*** from the nearest point of the baseline in the coast.

The Continental Shelf

The continental shelf of India comprises the seabed and subsoil of the submarine areas that extend beyond the limit of its territorial waters throughout the natural prolongation of its land territory to the outer edge of the continental margin or to a distance of ***two hundred nautical miles*** from the baseline in the coast, where the outer edge of the continental margin does not extend up to that distance.

India is said to have claimed before the UN authority on the law of the sea convention a continental shelf of ***more than 200 nautical miles*** based on scientific survey data. It is not known if the same has been accepted.

The Exclusive Economic Zone in the Sea (EEZ)

The exclusive economic zone of India is an area beyond and adjacent to the territorial waters, and the limit of such zone is two hundred nautical miles from the appropriate baseline in the coast.

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By far, the EEZ is the large area of the ocean where India has recognized economic rights under the terms of the UNCLOS 1982. Central indirect tax laws have been extended to apply to such areas. In the exclusive economic zone, the coastal State shall have the exclusive right to construct and to authorize and regulate the construction, operation and use of :

(a) Artificial islands;

(b) Installations and structures for the purposes provided for in Article 56 and other economic purposes;

(c) Installations and structures which may interfere with the exercise of the rights of the coastal State in the zone.

The coastal State shall have exclusive jurisdiction over such artificial islands, installations and structures, including jurisdiction with regard to customs, fiscal, health, safety and immigration laws and regulations.

Countries with the Largest Exclusive Economic Zones

S.No.	Name of the Country	Area of EEZ in Sq. Nautical Miles	World Rank in Area of EEZ
1.	USA	2,222,000	1
2.	Australia	2,043,300	2
3.	Indonesia	1,577,300	3
4.	New Zealand	1,409,500	4
5.	Canada	1,370,000	5
6.	USSR	1,309,500	6
7.	Japan	1,126,000	7
8.	Brazil	924,000	8
9.	Mexico	831,500	9
10.	Chile	667,300	10
11.	Norway	590,500	11
12.	India	587,600	12
13.	Philippines	551,400	13
14.	Portugal	517,400	14
15.	Madagascar	376,800	15
16.	Spain	355,600	16
17.	Mauritius	345,000	17
18.	Argentina	339,400	18
19.	Ecuador	338,000	19
20.	Fiji	330,900	20
21.	South Africa	296,500	21
22.	China	281,000	22
23.	Maldives	279,300	23
24.	United Kingdom	274,800	24
25.	Iceland	252,400	25

Source: The International Law of the Sea – by O. P. Sharma – Oxford University Press – 2009 edition

Some of the important benefits that India gets from the regime of the UN Convention on the Law of the Sea, 1982, called by the acronym UNCLOS, are :

- Full sovereignty over territorial waters.
- Economic Rights to the waters, soil, sub-soil, minerals in the contiguous zone, the continental shelf and the EEZ.
- Right to apply its **customs and fiscal laws** in the maritime zones.
- Right to authorize and regulate the construction, operation and use of artificial islands, installations and structures in the maritime zones.

Impact of the law of the sea rights in Indirect taxation

Now, "India" for tax purposes will include the areas as noted above, going beyond the land boundary of the country. These are deemed territories of India. The relevance of the tax laws to particular issues arising from the law of the sea could be posed here:

Central Excise Act

With the extension of the Central Excise Act to the maritime zones of India, any production of excisable goods in such zones will attract excise duty. So far it has been known that the oil exploration industry has been active in the designated sea zones, but there has been no published data whether the excise laws have been actually applied and what amount of excise revenue was realized. It may be noted that when any manufacturer supplies any excisable goods to such zones there cannot be any claim to export status even if foreign exchange is paid for the supplies.

Customs Act

With the promulgation of the maritime zones, these will be deemed territories of India and consequently supply of goods from within the Indian landmass to the entities such as oil rigs and vessels and terminals in the maritime zones will not qualify as export, and vice versa. This was made clear in the following case laws:

Aban Lloyd Chiles Offshore Ltd. & Others vs Union of India & Ors, (2008) 11 SCC 439 —Supreme Court of India

The principal issue for consideration in this case was :

Whether oil rigs engaged in operations in the exclusive economic Zone/continental shelf of India, falling outside the territorial waters of India, were foreign going vessels as defined by Section 2(21) of the Customs Act, 1962, and was entitled to consume imported stores thereon without payment of customs duty in terms of Section 87 of the Customs Act, 1962?

The Court held, inter alia :

"90. Our municipal law, i.e., Maritime Zones Act, 1976 is not in conflict with the international law, rather the same is in consonance with UNCLOS, 1982.

91. Article 127 of UNCLOS, 1982 deals with customs duties, taxes and other charges. Clause (1) provides that traffic in transit shall not be subject to any customs duties, taxes or other charges except charges levied for specific services rendered in connection with such traffic and Clause (2) provides that means of transport in transit and other facilities provided for and used by the land locked States shall not be subject to taxes or charges higher than those levied for the use of means of transport of the transit State. According to this Article, where the goods are in transit to other country shall not be subject to any customs duties, taxes or other charges except for the charges levied for specific services in connection with such traffic. In other words, there is no prohibition for levying customs duties on the goods which are not in transit for onward transmission to any other country. If the goods are brought in only while proceeding to other country, then no customs duty can be levied. In all other cases, it seems to be permissible.

92. In the present case, as the goods were being taken to a territory which would be deemed to be a part of the territory of India though the goods have left the territorial waters, the same would be eligible to levy of duty when they are taken and consumed within the deemed territory of India. There would be no customs duty or any other duty levied while the goods are in transit to the deemed territory of India by any other country although they have gone out of the territorial waters of India.

93. For the reasons stated above, we do not find any merit in these appeals and dismiss the same with costs".

The State VAT and CST Acts

The problem is seen to be more acute in the application of the VAT and CST laws to the maritime Zones of India. The following issues have come up:

A. Whether the supply of goods from India to the "deemed India" in the maritime zones can be described as inter-state sale within the meaning of the CST Act?

B. Whether the "deemed India" of the maritime zones is outside the scope of the jurisdiction of the states and by default will constitute "Union Territory"?

C. Who will levy and collect the taxes if any goods are supplied from the "deemed India" to other parts of India?

There are no convincing answers to such questions at present. The need of the hour is for legislation from the government to fill in such important lacunae in the existing statutes.

The Service Tax law as per Finance Act, 1994

Notification no. 14/2010 dated 27th February 2010 has extended the provisions of the service tax law to the maritime zones with a difference. Unlike other statutes with similar extensions, the service tax law applies only to the services pertaining to all the activities for the construction of vessels, structures and installations and any service provided or to be provided by or to such installations, structures and vessels and for supply of any goods connected with the said activity, within the maritime zones.

The language of the notification could not be more opaque than this. Instead of extending only the taxable services, the law appears to tax all the services in respect of such entities in the maritime zones. Whether this is permissible even in the maritime zones is a question that should suggest the answer. Services pertaining to the construction of vessels, structures and installations have not been specified. As a general category it is not mentioned in Section 65 of the Act, either. The legality of this special charging provision (under a subordinate legislation which is what the notification amounts to) for the maritime zones under the above notification is doubtful.

Conclusion

With the increase in ocean commerce and quickening technological development in the maritime zones further amplifying the scope for economic exploitation, the potential tax revenues from such zones could be considerable in the foreseeable future. However, the indirect tax laws have failed to keep abreast of the provisions in the international law of the sea and there is bound to be litigation with the uncertainty being neither fair nor desirable. The government would be doing a service to the stakeholders if it takes a good look at the Indirect Tax laws vis-à-vis the United Nations Convention on the Law of the Sea, 1982, that grants economic and fiscal benefits to India and comes up with suitable statutory regimes that do not leave stakeholders all at sea!! ❐

Technical evidences as foundation of facts in tax matters : Instruction No. 5/2011 dated 30-03-2011 of CBDT — an analysis and some suggestions including effective role of Cost Accountants

Dev Kumar Kothari*

The Supreme Court directed the CBDT to issue instructions to Income-tax Authorities about examination of technical experts where intricate technical aspects are involved and the examination of the same is necessary to understand factual aspects to decide tax matters involving huge revenue. As per author the directions of the Supreme Court are about examining technical experts. Author feels that Cost Accountants – having some basic knowledge of engineering and being more near to factories, sites, service centers and technical persons of organization – can act in much efficient way for the purpose of explaining technical aspects and producing technical evidences and experts before tax authorities. Author feels that the Boards instruction are not in accordance with the directions of the Supreme Court. The author has made some suggestions for consideration of the CBDT.

Complex technical issues of business affecting tax determination

With continuous advancement of technology, liberal and easy import of technology and technical implementations the business models are changing very fast. The nature of revenue and related expenses need to be understood in accordance with technical background of the case. For this purpose the tax authorities can ask for technical details and reports from tax payers/assessee. And in most cases the assessee provides the same so far relevant to ascertainment of tax liability.

Special knowledge of Cost Accountants can be helpful in producing technical evidence

Cost Accountants have special knowledge about industry, technical processes, etc. Cost Accountants study certain basic aspects of Engineering also in the course of ICWAI. This special knowledge is lacking in courses offered by ICAI and ICSI. Furthermore, by specialized and focused education and training about industry, industrial processes, documentation and reporting by industry, a qualified Cost Accountant is in a better position to understand technical aspects of industry and service sector. Cost Accountants have also expertise in tax aspects. They are working with industry and service organization. Therefore, Cost Accountants can play a significant role while explaining technical matters and producing technical evidences.

Cost Accountants are nearer and in regular contact with technical personnel, they dela with many technical matters on regular basis. Therefore, Cost Accountants are in better position to understand the language and expressions of technical people.

As an advisor on tax matters author always prefer to discuss issues with Cost Accountants and Cost Auditors of clients for understanding technical issues which many times are required to clear doubts about cost aspects related with power consumption, yield of raw materials–input–output ratios, fluctuations in consumption and cost pattern, reasons for high consumption and high wastage, relationship and correlation in input and output etc.

Therefore, author feels that Cost Accountants can be very effective in collecting, collating, arranging in proper manner and also producing, explaining and convincing about technical evidences.

Lack of understanding of tax authorities

Many disputes arise because the tax authorities do not understand or do not try to understand ground realities related with business or other activities of assessee. Even basic information provided by assessee is disregarded. Author had experiences that many times tax authorities deliberately disregarded the business aspects and even decided matters just to raise huge demands. Even simple business aspects, which could be understood by any common man, are disregarded. In such circumstances complex technical issues need consideration with open mind and not with a prejudiced mind of tax authorities.

Reliance can be placed on technical reports and evidences produced by assessee

When an adventure involving technical aspects is undertaken the tax payer prepares project report including technical feasibility report, get its people educated, informed and trained. Therefore, he has

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primary information as well as detailed information. Based on such information the tax payer undertakes the venture and places his capital at risk. If relevant aspects can be explained and understood by the tax authorities in a reasonable manner there will be no problem in taking decisions related with the technical aspects of business.

Another aspect of tax administration is that the assessee files his returns of income, TDS and other information return as per his understanding of law with help of experts. Whenever a claim requires closer examination, assessee takes advice of experts. In case of technical issues, advice and reports of technical experts is also considered.

Therefore, by and large, information provided by assessee including reports of experts on technical issue is reliable and tax authorities can rely on them—and in most of cases it is relied on also.

Experience also shows that disputes are arising because the tax authorities many times doubt the assessee without any basis.

Therefore, author feels that information and evidence provided by assessee can be fully utilized by tax authorities and only in suitable cases tax authorities should obtain independent opinion.

Court directions to Tax authorities

We find that many times courts, including the Supreme Court, direct or advise the tax authorities to follow certain guidelines or to issue proper guidelines for guidance of lower authorities. Unfortunately, in many situations and cases we find that the advice or suggestions given by courts are not followed and acted upon. Many times they are followed half-heartedly and unwillingly. We find that the Supreme Court had issued some directions to the CBDT about technical evidences and, recently, CBDT has issued a circular. Author feels that the circular so issued is not exactly what the Supreme Court has guided. The circular is likely to cause more doubts, confusion, delays and litigation. These are discussed hereinafter.

Observations and directions of the Supreme Court in case of Bharati Cellular

In an order dated 12.08.2010 the Hon'ble Supreme Court has made the following observations in the case of CIT, Delhi vs Bharti Cellular Ltd (Supra.) (with highlights added by author for anlaysis) :

"We are directing CBDT to issue directions to all its officers that in such cases, the Department need not proceed only by the contracts placed before the officers. With the emergence of our country as one of the BRIC countries and with the technological advancement matters such as present one will keep on recurring and hence, time, has come when Department should examine technical experts so that the matters could be disposed of expeditiously. Further, it would enable the appellate Forums, including this Court, to decide legal issues based on the factual foundation. We do not know the constraints of the Department but time has come when the Department should understand that when the case involves revenue running into crores, technical evidence would help the Tribunals and courts to decide matters expeditiously based on factual foundation."

An analysis of observations and directions of the Supreme Court and comments of the author are placed in the table below :

Observations and directions of the Supreme Court	Understanding of author
"We are directing CBDT to issue directions to all its Officers that in such cases,	This is direction of SC to CBDT
Department need not proceed only by the contracts placed before the officers.	Contracts placed before the officers is not only evidence.
With the emergence of our country as one of the BRIC countries and with the technological advancement matters such as present one will keep on recurring and hence time has come when	Technical advancement is continuous process.
Department should examine technical experts so that the matters could be disposed of expeditiously	Court's direction is that department should examine technical experts. The purpose is expeditious disposal, after understanding technical aspects from technical experts.
and further it would enable the appellate Forums, including this Court, to decide legal issues based on the factual foundation.	Technical facts are also required for deciding legal issues.
We do not know the constraints of the Department but time has come when the Department should understand that when the case involves revenue running into crores, technical evidence would help the Tribunals and courts to decide matters expeditiously based on factual foundation."	Constraints can be of proper manpower and time for examining and appraising technical evidences.

If we read the above instructions carefully, we find that the Supreme Court has directed that the department should examine technical experts.

This means that the departmental authorities should examine technical experts or their reports. As discussed earlier, the tax payer who has deployed large amount of capital has already engaged technical experts and obtained their reports. The Supreme Court has also asked to examine technical experts. This means technical experts of assessee.

This view of author is logical because when an assessee has entered into a highly complex business, and invested capital m, he has made preliminary enquiries, obtained technical reports, engaged technical experts, and therefore assessee is in a position to provide technical evidences in form of technical reports and in case of need by producing technical experts for examination and explanations before tax authorities.

The clear and possible view is that the department should ask the assessee to produce technical experts and/or their report for ascertaining the factual technical aspects. With due respect, author feels that the Board has considered this instruction of the Supreme Court as if the department should appoint independent technical experts and obtain their report and then provide reasonable opportunity to assessee to explain the same and give his comments etc.

Thus, as per author, there seems nothing in the instruction of the Supreme Court as to appointment technical experts by the department. However, apparently the CBDT has issued directions to keep it informed about technical experts to be engaged by the revenue and follow-up actions etc. This seems not in accordance with instructions of the Supreme Court.

Analysis of CBDT'S Order-Instruction— Income Tax

In terms of the above instructions of the Supreme Court, the CBDT has issued instruction 5/2011 [F.No. 225/61/2011-IT(A-II)], dated 30-3-2011.

The instruction reads as follows (with highlights added by author) :

Taking opinion of technical experts and bringing on record technical evidence in cases involving complex issues of technical nature and substantial revenue - Directions of the Hon'ble Supreme Court.

INSTRUCTION No. 5/2011 [F.No. 225/61/2011-IT (A-II)], dated 30-3-2011

1. The Hon'ble Supreme Court has made the following observations in an order dated 12-8-2010 in the case of CIT, Delhi vs Bharti Cellular Ltd.

"We are directing CBDT to issue XXXX expeditiously based on factual foundation."

(reproduced and analyzed earlier hence not reproduced again)

2. The above directions of the Supreme Court may be brought to the notice of all the officers in your region. In view of these directions in all cases that are taken up for scrutiny, the Assessing Officers/Transfer Pricing Officers should frame assessments only after bringing on record appropriate technical evidence that may be required in a case. The process of identification of such cases and initiation of the proceedings to obtain the technical evidence should be taken up well in advance before the date of limitation. The Officer concerned shall bring such cases to the notice of the CCIT/DGIT concerned, who will look into the complexities of the technical issues and monitor the progress of the case and if required assist in obtaining the opinion of the technical experts in the relevant field of expertise and endeavour to arrange for the opinion of the concerned technical expert well within time. Further, the evidence so gathered shall be made available to the assessee and reasonable opportunity provided before the assessment order is passed.

3. After a reference is made to an expert in the above manner, intimation must be sent of the Board through Member (IT) in the following proforma :

Name of case and Assessment year	Brief description of the technical issue involved	Name and address of the expert	Tax effect

An analysis of instruction

As per this instruction the department shall appoint experts and obtain opinion of concerned technical experts which shall also be made available to the concerned assessee and reasonable opportunity is to be provided to the assessee. A report in the proforma provided in instruction is to be furnished to the Board.

Whereas, as observed by the author earlier, as per directions of the Board, the AO should examine technical experts—means technical experts and their reports as may be submitted by the assessee.

Therefore, in opinion of the author the instruction issued by the Board is not in terms of the Directions of the Supreme Court.

Many important aspects are missing in circular

Even if we assume that the Supreme court has directed the department to gather technical evidences (it can be so presumed as per observation of the Supreme Court about Resources available with Department) then we find that the Instruction is incomplete. The instruction should also contain guidance about :

a. Monetary limits of revenue involvement where technical experts should be called for,
b. Nature of technical issues in which such reports should be called for,
c. What if the assessee has provided technical

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Telecom Mergers and Acquisitions

Puneet Jain *

Mergers and acquisitions in the telecommunications field have become a booming business as large companies scramble to acquire new IP technology companies. Telecom mergers and acquisitions are one of the hottest areas in the US economy.

Economic reforms have spurred the growth in the mergers and acquisitions industry of the telecommunications sector to a satisfactory level.

Telecommunication industry deals with various forms of communication mediums, for example mobile phones, fixed line phones, as well as Internet and broadband services. Both transnational and domestic telecommunications services providers are keen to try merger and acquisition options because this will help them in many ways. They can cut down on their expenses, achieve greater market share and accomplish market control.

Mergers and acquisitions in Telecom Sector can also have some negative effects, which include monopolization of the telecommunication products and services, unemployment and others. However, the governments of various countries take appropriate steps to curb these problems. In countries like India, mergers and acquisitions have increased to a considerable level from the mid 1990s.

Benefits of mergers and acquisitions in the Indian telecommunication industry

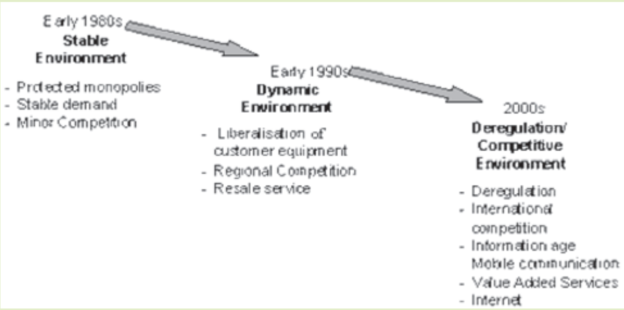
Mergers and acquisitions in the telecom sectorin India provide certain benefits in terms of—

Infrastructure—Building infrastructure for telecommunications is not easy. Moreover it consumes much time. Mergers and acquisition provides access to infrastructure much easily.

- Network—Benefits of existing network are available much easily through mergers and acquisitions
- License—In certain region there may be restrictions on getting new license. In such a case mergers and acquisitions provide an option to run services in that region.
- Customer base.
- Brand value.
- Spectrum.

India has become a hotbed of telecom mergers and acquisitions in the last decade. Foreign investors and telecom majors look at India as one of the fastest growing telecom markets in the world. Sweeping reforms introduced by successive Governments over the last decade have dramatically changed the face of the telecommunication industry. M&A in telecom Industry are subject to various statutory guidelines and Industry Specific provisions e.g. Companies Act, 1956;Income Tax Act, 1961; Competition Act, 2002;MRTP Act; Indian Telegraph Act; FEMA Act; FEMA regulations; SEBI Takeover regulation; etc. Telecom Regulatory Authority of India (TRAI) is of the view that while on one hand mergers encourage efficiencies of scope and scale and hence are desirable, care has to be taken that monopolies do not emerge as a consequence.

Changes in Telecommunication Envrionment



Throughout the world, telecom industry is being controlled by private companies instead of government monopolies. Traditional telecom technologies are also being replaced by modern wireless technologies, specifically in case of mobile services. One of the major objectives of telecom industry is to enhance the quality and speed of Internet technology.

Opportunities

- Rural tele-density is less than 10%.
  Overall tele-density is only 24%.
  Broadband penetration is just 0.25%, hence vast scope.
- BPO business is growing fast: Telecom can ride on it.
- Value added services like M-Commerce, M-Marketing, Special Information, Ring tones, and etc. offer venues of additional revenue.

* M.Com.,FICWA, ACS & LLB, General Manager (FA & Legal) & Company Secretary, Aajtak News Chennel

- As globalization is increasing, more percentage of global business for Indian telecom.
- Technologies like NGN, 3G, WiMAX, will open up new frontier of business.

Over the last few years, a phenomenal growth has been witnessed in the number of mergers and acquisitions taking place in the telecommunications industry. The reasons behind this development include the following:

- Deregulation
- Introduction of sophisticated technologies (Wireless land phone services)
- Innovative products and services (Internet, broadband and cable services)

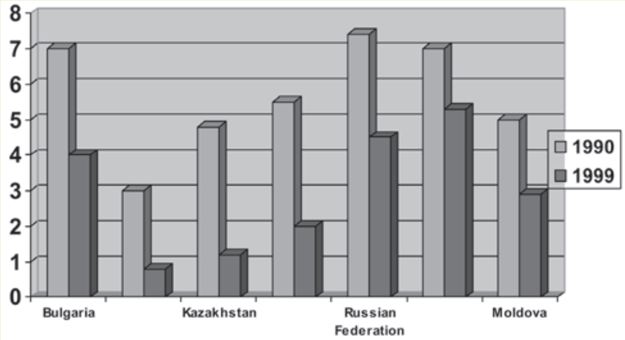
Both transnational and domestic telecommunication services providers are keen to try merger and acquisition options because this will help them in many ways. They can cut down on their expenses, achieve greater market share and accomplish market control.

M&A are also referred as Corporate Marriages and Alliances. Mergers can be across same or similar product lines. In many cases mergers are initiated to acquire a competing or complementary product. A reverse merger is another scenario in taxation parlance where a profit making company merges with a loss incurring company to take advantage of tax shelter.

Whether M & A In Indian Telecom Were Successful

A merger to be successful should create new capabilities, offer better value proposition to the combined entity's customers and above all enhance shareholders' value. Empirical studies prove that M&A brings with it the advantage of synergies to the operators and in majority of cases results in immense increase of shareholders value. M&A in Indian telecom industry has also benefited other stakeholders i.e. customers, Indian economy and society at large.

Private sector investment and FDI (Foreign Direct Investment) have also boosted the growth of mergers and acquisitions in the telecommunications sector.



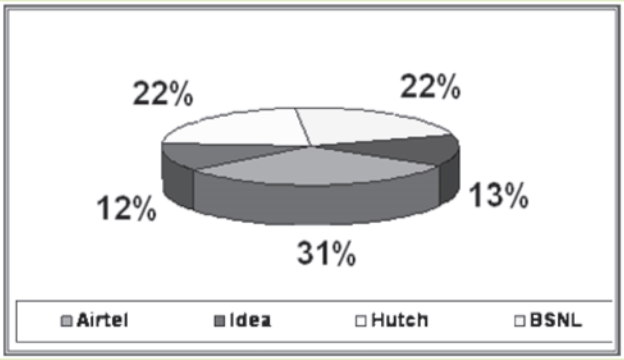
Data Source : World Bank Development Indicators International Telecommunications Union

Since India's Telecom Sector Trails that of other Asian Economies by About 10 Years, Growth is a Creatanity

- India is currently the second largest market in the world in terms of mobile subscribers.
- The Indian telecom market generated revenues of approximately US$ 32 billion in **2007-08.** Further, the industry is expected to register a CAGR of approximately 16 percent from **2007-08 to 2009-10** and scale to US$ 43 billion by **2010.**
- It is also expected that by **2012**, fixed line revenues will reach US$ 12.2 billion and mobile revenues will reach US$ 39.8 billion.
- Several foreign companies are making large investments in India.

Proposed Investments by Telecom Companies in India (US$ Billion)	
BSNL	1.3
Idea	2.4
Reliance	5.7
Aircel	5
Quippo telecom infrastructure (QTIL)	3
Vodafone	6

The telecom sector is growing,



- Overseas is actually where most of the growth is expected to take place in the next few years. According to the *Wall Street Journal*, projected cell phone revenue between **2007 and 2012** is 96% in China and India; 53% in Africa and the Middle East and 42% in Latin America. Developed markets, like Western Europe, are projected to see about 13% growth.
- And here's some food for thought: the world's richest person, Carlos Slim Helu, holds a controlling interest in some telecom companies. This includes America Movil (AMX), Latin America's largest mobile phone business.

Conclusion

Critics claim telecom mergers reduce competition and promote monopoly. In reality, these mergers are part of a healthy competitive process and would foster innovation and bring benefits to consumers.

Finally, the success of a merger hinges on how well the post-merged entity positions itself to achieve cost and profit efficiencies. As Robert C Higgins of University of Washington points out "careful valuation and disciplined negotiation are vital to successful acquisition, but in business as in life, it is sometimes more important to be lucky than smart." ❒

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reports—whether department should obtain separate report, if yes , the circumstances when such exercise is needed,

d. Registration/recognition/empanelment of experts,

e. Independence of experts—they should not be influenced by revenue and assessee.

f. Fees payable to experts and who will bear the same. Naturally the revenue should bear the cost for obtaining such reports.

In view of the above discussion author feels that the Board need to reconsider its instructions and can come out with new instructions about :

a. Circumstances in which assessee should be called to lead technical evidences,

b. Instructions about technical reports and technical evidences which can be collected from assessee, without any way causing leakage of technical secrets which are foundation of business of assessee.

c. Circumstances in which technical experts can be called from assessee and type of technical experts. For example Cost Accountant or Cost Auditor of factory or service centre can be called to provide preliminary evidences, reports and discuss technical aspects related with tax aspects. Then in case of need other technical personnel can be called upon. In a way Cost Accountant/Cost Auditor can be considered as a linking pin to produce and explain technical evidence and technical experts,

d. Monetary limits of revenue involvement where technical experts should be called for—from assessee and in cases where independent experts can be appointed by revenue,

e. Nature of technical issues in which such reports should be called for,

f. What if the assessee has provided technical reports—whether department should obtain separate report, if yes, the circumstances when such exercise is needed,

g. Registration/recognition empanelment of experts—to be appointed by revenue and in such cases their independence, fees payable to experts and who will bear the same. Naturally the revenue should bear the cost for obtaining such reports if it wants to increase its revenue.

Suggestions to the CBDT—Engineers/ Scientists working as RAS officers can play effective role

We find that there are many qualified engineers and scientists working as Tax Officers at different levels in the Income Tax Department as they preferred to join revenue service instead of working as engineers or scientists. These officers have knowledge and expertise and can understand technical aspects. Therefore, a list of such officers can be prepared. When a technical issue arises, assessee can be asked to furnish report and details on technical aspects. ❒

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Ill Effects of Black Money on Growth of Economy

V. Gopalan*

According to the data provided by the Swiss Bank, India is topping the list with almost $1500 billion of its black money deposited with them, followed by Russia $ 470 billion, UK $390 billion, Ukraine $100 billion and China with $96 Billion. It looks like India's share is more than rest of the world combined, 13 times larger than the nation's foreign debt and about 40% of GDP of India. Every year this amount is increasing at a rapid speed.

It is a record embarrassing for any country to top the list for these reasons. The black money issue is haunting the government for quite some time and our Supreme Court is also monitoring the steps taken by the government in putting an early end to this menace.

As pure water when polluted or contaminated loses its value, the economy of any country would be in jeopardy when contaminated with black money as it amounts to parallel economy not contributing in any way to the growth of the country.

It is not that only India is facing this problem. It is omnipresent. But what is worrying is that it is crossing the tolerance of even average citizens as they are witnessing the economy resisting growth as parallel economy is acting as a deterrent.

Bringing back the black money stashed in foreign banks is, of course, the primary task of the government as it is a matter of pride more than anything else. Viewing from the angle of government exchequer, it is estimated that the Indian Government can run without levying any taxes for next about 3 decades! In a nation where more than 450 million live below the poverty line, bringing back the black money means so much. India has huge foreign debts and this would reverse the position from deficit to surplus.

India's external debt, as at end March 2011, was placed at US$ 305.9 billion (17.3 per cent of GDP) recording an increase of US$ 44.9 billion or 17.2 per cent over the end-March 2010 level on account of significant increase in commercial borrowings, short-term trade credits, bilateral and multilateral borrowings. The long-term debt at US$ 240.9 billion and short-term debt at US$ 65.0 billion accounted for 78.8 per cent and 21.2 per cent, respectively, of the total external debt as at end-March 2011. Considering the size of the economy (India's GDP as on March 31, 2010 as per World Bank data is US$ 4,198,609 and that of China on the same date is US $ 10,084,764), the outstanding total external debt of China of USD 585.97 billion as at end March 2011 clearly indicates the huge level of India's indebtedness. Also, as seen above, the black money of China is estimated to be far less than that of India.

China's economy, about the same size as India's US $ 183 Bn in 1980, has swelled close to $ 5 Tn, almost four times that of India in 2010. Real GDP growth in China has averaged 10% annually over the past 30 years, compared with 6.2% in India. During this period, China's GDP grew 16 times to $5 trillion whereas India's rose seven times to $1.2 trillion. China's exports (including services) surged 65 times over this period to $1,330 billion while India's exports increased 22 times to $250 billion. China has overtaken Japan to become the world's second-largest economy. China's demographic transition pushed up its savings rate above 30% in 1985, while India's savings rate crossed that level only in 2005. These are the published reports we get from various sources. 'Is India lagging behind because of a huge parallel economy?' is the question of all Indians now.

Economic development in India has broadly two facets viz. quantitative and structural. The above quantitative details prove that we have been missing out our opportunities though economically well placed.

The world is currently growing through the third super cycle, a period of sustained high economic growth, which will go till 2030 and India and China will be the biggest beneficiaries from the current cycle. The previous two super cycles were 1870-1913 (led by the US) and 1946-1973 (led by Japan). For India, the biggest positive is the conducive demographics and the country will continue to grow on the domestic demand front rather than being an export hub like some of its Asian peers. And it is a young country. At a time when much of the industrialized world faces rapidly declining birthrates, half of India's population is under the age of 25.

But, with more of foreign debt and continued outflow of Indian funds away from India, it is likely to upset all the possibilities of sustained growth.

Brazil and Russia may be emerging more attractive than India to foreign investors this year, as the

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domestic economy is plagued by inflation and high commodity prices, say experts. These emerging markets have the advantage of being commodity producers and are benefiting from rising prices. India, on the other hand, is a net commodity importer. Inflation is due to higher cost of production towards increased higher levels of borrowings and the cure for the malady is repaying our external debts with our funds stashed abroad.

The Indian economy is a mixed economy. It has acquired this form with the growth of a large public sector with a dominant private sector. And, parallel economy is a threat to both the sectors.

Despite several studies since 1950s, the exact estimate of the black economy has remained elusive. The government has commissioned a study by three experts to estimate the size of the black economy and is expected to provide more insights by 2012 end.

There were earlier studies made on this aspect. A study conducted in 1955 by noted economist Nicholas Kaldor estimated the black economy about Rs 600 crore (about 4-5% of then prevailing GDP) and another study by Justice Wanchoo in 1969 estimated the size of black money in India at about Rs. 7,000 crores. A study conducted by the National Institute of Public Finance and Policy under the chairmanship of Raja Chelliah in 1981 estimated the black economy at 20% of GDP, i.e., about Rs 15 lakh crore. A study by S B Gupta in 1992 put the figure at 42% of GDP for 1980-81 and 51% for 1987-88. Experts say it is difficult to put an exact number to the problem.

Arun Kumar, Professor of Economics at Jawaharlal Nehru University who has authored the book , 'Black Economy in India', estimated its size in 2005-06 to be 50% of GDP, ie roughly Rs 39 lakh crore. He says about 10% of this has gone out of the country through 'hawala' and 'trade under and over invoicing'. Kumar states in his book that scams play crucial role in generation of black income. And, all sectors of the economy, whether it is real estate, construction, agriculture or services, contribute to generation of black money; and the services sector is the biggest generator of black income, reveals his study.

Studies and reports on these lines are only increasing and substantiating day by day the gravity of the problem and the urgency to combat and fight against them.

To name a few, the following are the results of the parallel economy :

Low per capita income

The 'per capita' income of India has been not growing in line with the other advanced countries despite the liberal measures taken by the government since early 1990s. Even after several decades of planning and push in the right direction, India still remains an underdeveloped economy in terms of per capita and continues to be a low income economy. One of the reasons for low per capita income is the parallel economy running alongside our original economy, creating hurdles and obstacles in fulfilling the goals of our country. It is like running a parallel government.

Mass poverty

Parallel economy results in inequitable distribution of income—thereby higher incidence of poverty—as people get affected indirectly in so many ways.

Unemployment

In view of inadequate growth, industrial and otherwise, due to lack of capital—as large capital is not deployed in India—widespread unemployment is prevalent and perhaps the most striking symptom of inadequate development in India. Unlike developed economies where the unemployment is cyclical, in India it is chronic due to slow or no growth in many sectors.

Lack of Technology

As stated above, India is facing the problem of shortage of capital due to black money. This has the direct impact on the technology upgradation in all sectors. The major reason behind such backwardness is the parallel money.

The High Level Committee headed by Central Board of Direct Taxes Chairman Prakash Chandra has been appointed by the government for tracing black money stashed away abroad and unearthing such ill-gotten wealth in the country. And, the government set up another panel to suggest ways to trace tax defaulters, reveal their identity to the public, and recover taxes. The panel on black money will suggest modalities for utilisation of the information available with the Financial Intelligence Unit—India (FIU-IND) and the Directorate of Income Tax (Systems) with a view to recovering outstanding demands. Besides, the government announced a five-pronged strategy to deal with the menace of black money, including setting up of a Directorate of Criminal Investigation to deal with tax-related crimes.

The action of the Government shows its commitment to abolish 'black money'. Though it is not entirely possible to eradicate black money unless major and radical changes take place world over, it cannot wait any longer! ❐

Salient Features of the Order Dt. 30th June 2011 by MCA, CAB regarding automatic Cost Audit for 8 products

V. R. Kedia & Dipti Kejriwal*

Recently, the Government of India, Ministry of Corporate Affairs, Cost Audit Branch has published the Notification/Order F No.52/26/CAB–2010 Dt. 30th June 2011 in modification of their earlier Order of even number dated 3rd May 2011 covering 8 products under automatic Cost Audit and their linkage with the relevant chapter heading of the Central Excise Tariff Act, 1985.

The salient features of the Order are :

(i) The 8 Industries covered are — Cement, Tyres and Tubes, Steel, Paper, Insecticides, Glass, Paints and Varnishes and Aluminium.

Steel tubes and pipes are automatically covered under "Steel" chapter of the Central Excise Tariff. Therefore, 'Steel tubes and pipes' have been deleted in this Order.

The definition/applicability of these 8 products has been linked to the relevant chapter heading of the Central Excise Tariff Act, 1985.

The relevant Excise Chapters mentioned in the Order of each Industry also list out raw materials used for such products. However, it is opined that such raw materials will not be covered by the automatic Cost Audit.

In view of linkage of definition of the product/industry with the relevant chapter heading of the Central Excise Tariff is a good move made by the Government, to avoid any interpretation problem. However, with the exception of 8 products for which Cost Accounting Record Rules for specific Industry are continued and other 8 products as referred above which are linked to the relevant chapter heading of the Central Excise Tariff, remaining 28 products which are subject to Cost Audit (whose individual Records Rules have been abolished) have been left open by the industry to interpret the applicability part.

It is suggested that the Government should come out with linkage of products of these 28 industries with the relevant chapter heading of the Central Excise Tariff, soon.

(ii) 'Glass' is newly covered product/Industry, bringing the total products covered under Cost Audit to 45.

(iii) Cost Audit is compulsory for all companies engaged in the above referred products, if they are coming under applicability criteria under this Order.

Henceforth, Cost Audit Branch will not issue Cost Audit Orders to individual companies, which are subject to applicability clause of this Order. Such companies will be automatically covered for Cost Audit. Further, all companies for which individual Cost Audit Orders have been issued so far for such products shall continue to comply with the said orders.

(iv) Applicability and definition of these products have been linked to the relevant Chapter Heading of the Central Excise Tariff Act, 1985, as listed in the Order.

(v) Intermediate products and articles or allied products of above industries, if included under any other Chapter of the Central Excise tariff Act, 1985—shall also be covered under these Orders. There are some products which are listed in more than one Excise chapters. Further, the interpretation of allied products of such industries is very vast and will cover a large number of products. Therefore, it is better that our institute should list out the intermediate products and articles and allied products which will be covered under relevant Excise chapter heading.

(vi) In view of above, a large number of products and companies will be additionally covered by the Cost Audit e.g. Cement products such as Cement pipe, Steel products covering barrels, paper and paper board articles (Cartons, boxes, tubes, bobbins, spools) Glassware, Bottles, ampoules, vials, aluminium products and articles.

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(vii) Application for appointment of Cost Auditor for companies covered first time under these modified orders shall be within 90 days from the date of issue of these orders, instead of from the date of commencement of the financial year (as was mentioned in the earlier orders).

Some of the companies, who were covered first time for the Cost Audit vide Orders dated 2^{nd}/3^{rd}May 2011, are facing a practical problem in complying with provisions of even appointment of Cost Auditor within 90 days of issue of the Orders, since their next meeting of the Board of Directors will be held sometime in the first–second week of August 2011. In such cases, it is suggested that the company can appoint the Cost Auditor by passing a Circular Resolution.

(viii) The applicability criteria to the company shall be the same as per earlier Order dated 3^{rd} May 2011, i.e. as on the last date of the immediately preceding year –

(a) Aggregate value of the turnover from sale or supply of all products or activities exceeds Rs. 100 crores, or

(b) The company's equity or debt securities are listed or are in the process of listing on any stock exchange, whether in India or outside India.

(ix) Product/Industry-wise Cost Accounting Records Rules are not applicable to such companies, but Generally Accepted Cost Accounting Principles (GACAP) issued by the ICWAI shall be followed.

(x) The provisions of the Companies (Cost Audit Report) Rules, 2011 vide GSR 430(E) dated 3^{rd} June 2011, shall be applicable.

(xi) Penalty provisions for non–compliance or delay in submission of the Cost Audit Report are same as per existing provisions.

(xii) Effective Date : This Order is effective from the financial year commencing on or after 1^{st} April, 2011. ❐

Men at the Helm

Sri Gali Narayan Rao has assumed charge as Chairman and Managing Director of Artificial Limbs Manufacturing Corporation of India (ALIMCO), a Central PSU under the Ministry of Social Justice and Empowerment, at Kanpur on 27th May, 2011. His last assignment was with Bharat Dynamics Limited, under Ministry of Defence as General Manager (Corporate Financial Services). He is a Fellow Member of the ICWAI, Fellow Member of the ICSI and also a Law Graduate. He has been unanimously elected Chairman of Hyderabad Chapter of ICWAI for the last three consecutive years (2008-2011). He is a Member of All India Tax Practitioners Federation and Member of Committee of FAPCCI on Corporate Social Responsibility.

We wish him the very best in all future endeavour.

Balanced Score Card (BSC)—a useful management tool for transforming corporate management strategy into action focusing on critical issues— a study of development and its increasing use in business

Parimal Ray*

Background

To fly high in the Competitive Corporate sky, management has to be constantly monitoring the teams' achievements and ensure tracking of the resources mobilization path to produce best output. This necessitates need for not only activities translated into financial terms to be under the control umbrella but also numerous non-financial perspectives of business having substantial impact on its bottom lines, image and growth potential as well. To serve this multi-dimensional objective attainment process, management tools are developed from time to time, mostly with the strength of experience of managing business entities.

From the time human efforts faced the challenge of competition, appraisal of performance emerged as predominant tool for assessing the root cause for non-performance or lower performance and taking appropriate timely action to recover. In business, management team is continuously engaged in multidimensional and multitasking activities – starting from strategy formulation, planning for achieving the corporate goals, tracking results and side by side focusing on areas for improving performance. Be it financial or non-financial in nature, objective attainment in business endeavor needs constant monitoring against set plans and targets.

Over the years, along with other functional subjects, business management has also undergone revolutionary changes—particularly from the 19th century. One of the main drivers for searching best alternative option began with mainly from that time when managers of economic operations felt the scarcity of energy resource and competitive market.

Among number of initiatives, advent of **Balanced Score Card (BSC)** concept in early 1990s gave a further impetus towards improving business performance through tracking of major or critical aspect of business function having substantial direct or indirect effect on its results, growth and increasing market potential in today's competitive world through FOCUSED planning, monitoring and corrective actions.

What is BSC

Balanced Score Card **(BSC)** is the presentation of a mixture of financial and non-financial measures, each compared to a 'target' value within a single concise and compact management report. BSC never aimed at replacing traditional financial or operational reports, rather, it works a succinct summary capturing the information in most relevant manner for the reader of the fact sheet. BSC is a method of determining the Most Relevant information through the appropriate designed processes. Because of the uniqueness of the process, it could keep itself at a different platform from that of the various versions of other tools in circulation.

Journey of BSC mechanism

A. 1987-early 1990s— Conceptualization and formation of BSC

Alfred Chandler, the noted Management historian, said that roots of performance management as an activity run deep in management literature and practice which can be seen in the emergence of the complex organization—most notably during the 19th century in the USA. However, the first balanced scorecard was conceptualized and articulated by an independent consultant on the management of processes in 1987 by Art Schneiderman at Analog Devices, a medium sized semi-conductor organization. He also participated in a study in 1990 led by Dr. Robert S. Kaplan in conjunction with David P. Norton of US management consultancy firm, Nolan-Norton, and during this study described his work on Balanced Scorecard. Subsequently, Kaplan and Norton made elaborate details about the use of BSC in their article in 1992. This paper was not only the first step in this context but also earned popular success. This was followed by revision of the concept in 1993 and, finally, in 1996 through their authored book—The Balanced Scorecard which, perhaps wrongly, led to the idea in people's mind as "they

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being the originator of the BSC concept" whereas the first man to coin this concept was Art Schneiderman.

One major driver influencing towards the above idea might include the pioneering task of General Electric in 1950 on various aspects of operation though there is no explicit proof of its influence having link with the remarkable contribution by Schneiderman, or Kaplan & Norton in, the field of business enterprises' performance upgrading efforts.

B. BSC — 3 Generation improvement

(a) BSC—1st generation 1991 : Kaplan and Norton first articulated this concept in their published work. BSC, as performance measurement system which is derived from vision and strategy, reflects the most important aspects of the business, supports strategic planning and implementation, aligns the actions of all parts of an organization around a common understanding of its goals, and facilitates the assessment and upgrade of strategy through a single score card or matrix covering the most relevant aspect with their individual targets and planned action process.

In an effort to provide information-age enterprises with efficient planning tools, Kaplan & Norton introduced the Balanced Scorecard consisting of four different perspectives from which a company's activity can be evaluated :

- **Financial perspective**—which describes what the company provides its shareholders
- **Customer perspective**—which describes how customers see the company
- **Process/Internal perspective**—which describes what actions need to be performed
- **Learning and Growth perspective**—which describes how a company can stay successful.

The major challenge faced with this type of Balanced Scorecard is justifying the choice of measures or perspectives made and thus Balanced Scorecard prepared based on not well chosen criterion often leads to less confidence in the information it provides.

(b) BSC—2nd generation in mid 1990s : an improved design method emerged with strategic objectives a distributed across the four measurement perspectives, so as to connect the most relevant issues to form a visual presentation of strategy and measures.

Under this process, strategy map is designed by managers selecting a few strategic objectives within each of the perspectives, and then define the cause-effect chain among these objectives by drawing links between them and, thus, a balanced scorecard of strategic performance measures is derived directly from the strategic objectives.

Due to the greater linkage with the strategic objectives with cause-effect relationship for the measures chosen, it becomes normally easier for managers to work through as meaningful exercise.

(c) BSC—3rd Generation in late 1990s : the design approach had undergone change again. One problem with the "2nd generation" design approach described above was that the plotting of causal links amongst twenty or so medium-term strategic goals was still a relatively abstract activity. In practice, it ignored the fact that opportunities to intervene, to influence strategic goals are, and need to be, anchored in the "now;" in current and real management activity. **Secondly,** the need to "roll forward" and test the impact of these goals necessitated the creation of an additional design instrument; **the Vision or Destination Statement.** This device was a statement of what **"strategic success,"** or the "strategic end-state" looked like. It was quickly realized by all concerned that if a Destination Statement was created at the beginning of the design process then it was much easier to select strategic Activity and Outcome objectives to respond to it and measures and targets could then be selected to track the achievement of these objectives. Design methods that incorporate a "Destination Statement" or equivalent (e.g. the Results Based Management method proposed by the UN in 2002) represent a tangibly different design approach to those that went before, and have been proposed as representing a "3rd Generation" design method for Balanced Scorecard with wide acceptance and being purposeful to the business managers.

Balanced Score Card—Matrix

An example with some key perspectives

Financial Perspectives

Challenges/ Threats	Objectives	Target	Measures/ action to take
Higher Marketing cost due to bigger clients	Efficient marketing	Reduction in per patient/client marketing cost	Appoint professional marketing team, introduce Bonus on performance basis

Customer Perspectives

Challenges/ Threats	Objectives	Target	Measures/action to take
Low pace increase in Public Sector clients	Higher revenue	Exploring Private clients	Introducing Sales motivation schemes

(contd.)

(contd.)

Challenges/ Threats	Objectives	Target	Measures/ action to take
Increasing risk of bad debt	Improve collection system	Zero bad debt	Introduce client account financial appraisal
Hit on Cash flow	Improving cash position	Nil or minimum borrowings	Introduce cash payment system and cash discounts

Financial Perspectives

Challenges/ Threats	Objectives	Target	Measures/ action to take
Customer needs for higher value addition	Convincing customer with ability to provide the needed value	Customer satisfaction oriented value addition	Innovative team to deploy for assessing the value based need of the customers
Change in the pattern of customer – due to hospital amalgamation	Customer needs to be redefined (not only price but also the quality/ hygiene)	Convincing Customer about the best quality and assurance of best hygiene	Focus on the training of ground staff, quality awareness program

Customer Perspectives

Challenges/ Threats	Objectives	Target	Measures/ action to take
Increase in efficiency and bargaining by larger clients	Increase price	Innovative packages	Modern packages with higher price with professional sales team
Complacency due to higher profit-reducing pace of growth	Shred off the self satisfaction mindset	Newer targets with broader vision	Regular R & D activities on both product/service and economic process
Client needs helps for innovative services to improve its own business	Innovative ideas in service packages	Becoming the leader in the concept conceiving	Encouraging innovations through rewards

Challenges/ Threats	Objectives	Target	Measures/ action to take
Lower working skill employees reducing the image of the enterprise thereby dropping market image	Achieving the leader image in the market with high quality staff	Providing client with a knowledge base support staff in the whole process	External and internal on-the-job-training to staff in their respective fields of work
Innovative skills possessed by competitors – may outplace in the long run	Retaining the position in the market and to grow	Newer product to bring in the market before others	Continuous scheme for consultants' views and training by leaders for product/service package development
Old markets are slowing down	Existing clients need to be told about new/improved types of needs	Generating demand of different product/service	Superior technology and manpower with Sales potential to be employed and rewarded

Shortcomings & Criticisms of BSC mechanism

Major criticism and doubts raised in respect of success of the implementation of BSC as a efficient management tool are from the area of Poorly Defined Matrix, Lack of Efficient Data Collection and Reporting, Lack of a Formal Review Structure, Too Much Internal Focus and inadequate Process Improvement Methodology. (Source : Problems implementing a Balanced Scorecard by Stephen Smith, Senior Vice-President and Managing Executive, Rummler-Brache Group published in BPM Institute.org website).

BSC—like any tool—cannot be expected to work like a readymade instantly useable recipe for management success. Even taste of the chicken cooked as per same Recipe differs widely depending upon multiple factors like the proportion and make of ingredients use, actual temperature and its variations during cooking, quality of chicken, and so on. Similarly, like any tool, while using BSC, adequate care needs to be taken starting from selection of the perspective criterion to be put in the BSC matrix so that these are linked to the corporate multi- dimensional goal congruence, flexible enough to accommodate changes over time and also reasonably simple to understand. But, in practice, often corporate managers—while formulating the BSC model for their organization—misses the link between the strategic plan and the implementation process through the BSC mechanism leading to failure of the process to produce desired result. The major difficulty is faced in assigning weightage to the different perspectives and establishing cause and effect relationship among them has been found to be the most critical issue in the implementation of the Balanced Scorecard in Indian Corporate environment. The other difficulties faced include assigning weightage to different measures within the perspective and quantifying them and lack of clarity therein arising from a large number of perspectives—again resulting in lack of success of the system.

Success of BSC tool in Western countries and in India

The BSC has its successful application path across diverse industries and in public sector in the US management culture *vis-à-vis* the UK management culture. In 2003, Spechbacher, in his survey of 174 senior management executives from German-speaking countries—namely, Switzerland, Austria and Germany—found that 26 per cent of the business firms use the Balanced Scorecard in a limited way at the business unit level or use its incomplete version—

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Voluntary Guidelines on Corporate Governance and Corporate Social Responsibility (CSR) – a tool to enhance the Brand value of a country

Nilakanta Shastry Tata*

Corporate Social Responsibility (CSR) has undergone remarkable changes over the years from merely dispensing cash by way of charity to organisations or NGOs engaged in social work.

Corporate "Outreach Programmes" include all stakeholders viz., shareholders, employees, customers, suppliers, project affected people—directly or indirectly.

The current understanding of CSR also attempts to deploy a company's core competencies to help address the society's problems. Numerous examples can be given viz., Tatas, Birlas, Mahindras etc., from the Corporate side. Even media print and television—have come up with brilliant ideas in educating the masses (Times of India teach programme), CNN-IBN's Citizen Journalist programmes etc.

With Indian economy expected to grow 8-9% annually with one of the youngest population in the fore in the world, responsibility of Government, Corporates and all other stakeholders of the Society in which we live increases to preserve, protect and mitigate the hardships of the people of India and across the globe.

Continuous development encompasses in it various vagaries which, left unchecked, lead to natural calamities. In order to sustain the growth and minimize and mitigate the hardship to the people living in the society it is imperative that each stakeholder of the society—be it Government agencies, Corporates or others—to effectively deal with the situation in a planned manner.

In this context the CSR Voluntary Guidelines, 2009, published by the Ministry of Corporate Affairs, Government of Inida, brings to the fore six important aspects :

1. Care for all Stakeholders
2. Ethical Functioning
3. Respect for Workers' Rights and Welfare
4. Respect for Human Rights
5. Respect for Environment, and
6. Activities for Social and Inclusive Development.

Let us examine them from the Corporate perspective and to create a brand value for a country as a whole :

Care for all Stakeholders

Depending upon the business entity's operations it should endeavour to expand its horizons beyond mere employees, suppliers etc. It should encompass the society as a whole where, say, its manufacturing activity is being set up, environmental issues, social and all other related issues need to be addressed effectively to the satisfaction of all concerned. It is not merely obtaining NOC from the respective Statutory authorities. It should be imbibed in the corporate culture how to protect and preserve the environment in which it intends to operate. How to manage with the affairs of the local people, their displacement issues, readjustments, difficulties etc. have to be discussed in advance and resolved amicably. If one adopts a "all-inclusive" approach, many "after- effects" can be eliminated.

Ethical Functioning

There is no precoined word called "corporate ethics", the personnel who are in the control of the affairs of such corporates need to have high ethical values. This again stems up from the individuals' upbringing, education, societal pressures, "intent" to uphold values in one own life etc. A corporate being a legal entity controlled by human beings – corporate culture is nothing but true reflection of personnel operating such corporate/organisations.This aspect plays a very vital role in CSR. The acts done under CSR should be absolutely to benefit all stakeholders and society at large.

Respect for Workers' Rights and Welfare

Safe, hygienic and humane workplace environment not only increase productivity but also leads to overall well-being of the organisation and society at large. Creation of Brand value for an organisation emantes internally from its employees and other stakeholders which, in turn, leads to better brand image of the organisation.

Organisations hugely benefit from such brand building which is essential to sustain the competitive market environment. It is also true that a nation can have a brand image for itself.

Example : German quality…. Quality… is key for any German product. Worldover, Germany has created in the minds of the people that Germany as a country will not compromise on "quality"—hence any product coming out of Germany will have the required quality standard.

Based on the above, how will India present itself to the world as a "Brand"? On what parameter(s)?

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Respect for Human Rights

Human rights pervades many aspects – Corporates should show in letter and spirit that they value human rights – respecting all caste, creed, colour, sex and nationalities as an equal opportunity employer/ stakeholder.

Respect for Environment

This is taught by our Indian forefathers – respect environment which includes earth (land), air, water (rivers), trees, mountains, and all biological species. with utmost respect. Revere's them as GOD.

Natural calamities taking place in today's world is all making of human beings who shamelessly misuse the natural resources for their selfish ends. This needs to be guarded effectively by the Corporates and general people of society in order to preserve the ecological balance effectively.

Reporting on alternative source of energy development, conservation of energy and appropriate utilization of energy resources have all become part and parcel of Annual Reports of many Corporates. This should not be left to only few Corporates or Governmental initiatives. It should be a mass movement at the grassroot level and each citizen of any country need to be associated in order to bring about a change in the alarming global warming signals which may, ultimately, affect all, globally.

Activities for Social and Inclusive Development

Corporates engaging themselves in areas need to see that the area is well protected from ecological degradation, balancing environmental and societal needs. Give adequate representation to the local populi in order to uplift their economic stature. Create good culture, values, ethics so that it is imbibed not only in the vicinity but also all around.

Effective CSR today is that which relates directly to the giver's core competencies and offers real value, not just philanthropy. It is no longer considered good for business, but simply good business.

Because, when you give back to the society you operate in, you become truly embedded in that society, rather than being perceived as seeking profits alone—

Giving is better than receiving because giving starts the receiving process. — *Jim Rohn*

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(***Source*** : Spechbacher, Gerhard, Bischot, Juergen and Pfeiffer, Thomas (2003). "A Descriptive Analysis on the Implementation of Balanced Scorecards in German-speaking Countries," Management Accounting Research, 14(4), December, 361-387).

Study reveals that the rate of adoption of Balanced Scorecard is well above 45 per cent in corporate India which compares favourably with 44 per cent in the US as per the survey made. In this context, it is found that the financial perspective is the most important perspective followed by customers' perspective, shareholders' perspective, internal business perspective, and learning and growth perspective. Along with these perspectives of predominant importance, the environmental, social, and employees' perspectives also figure in it. In fact, Corporate India mostly monitors the indicators as per ISO 14000 norms in the environmental and social perspectives of the performance scorecard (Source : Balanced Scorecard in Indian Companies—Manoj Anand, B S Sahay, and Subhashish Saha, published in Vikalpa• Vol. 30 • No. 2 • Apr-Jun 2005).

From the various corporate reports, surveys and communications, it reveals that by this time BSC has gained its glamourous presence in Corporate World as one of the successful instrument for strategies to transform into implementation. This largely depends on how the perspectives are selected and connected to the overall business strategic goals of the corporate entities.

Conclusion

For inherent flexibility requirement and object orientation in focused manner, corporate strategic management team prefers this BSC tool for driving the strategic plan into action. This modality is already well accepted—mainly in the developed and under-developed countries—particularly for its strength in areas like—

- BSC helps align key performance measures with strategy at all levels of an organization.
- It provides management with a comprehensive picture of business operations.
- The methodology facilitates communication and understanding of business goals and strategies at all levels in the organization.
- The balanced scorecard concept provides strategic feedback and learning.

Due to embedded linkage between desired strategic Activity and Outcome objectives through a proper destination statement in the BSC matrix, BSC concept has already gained overwhelming responses from the corporate leaders all over the industrially advanced and developing world including India in spite of its criticality and difficulty in process of selecting and modulating the most appropriate BSC matrix for an organization.

In the present ever-changing and competitive environment coupled with demand from the angles of socio-economic and environmental corners for a greener planet and for future generation to play, BSC concept is a most needed one for the management to strive for their organization's growth and sustainability and to have a smooth flight in the corporate sky. It is the time for Indian Corporate management and business leaders too, to not only implement the BSC but also to contribute towards improving its mechanism for a greater success tomorrow by the business community at large. ❐

Backflush Costing

Harneet Kaur*

Backflush Costing is a non-traditional type of costing that complements just-in time inventory systems. It is a lesser-known type of costing system. This is a type of costing system that is based on the philosophy that inventory is a not a value-adding activity. Most often backflush costing systems are seen as an integrated part of just-in-time (JIT) inventory systems. Due to the pull system involved with JIT inventory systems, backflush costing tends to work better than other traditional types of inventory systems.

It is a product costing approach, used in a Just-In-Time (JIT) operating environment, in which costing is delayed until goods are finished. Standard costs are then flushed backward through the system to assign costs to products. The result is that detailed tracking of costs is eliminated. Journal entries to inventory accounts may be delayed until the time of product completion or even the time of sale, and standard costs are used to assign costs to units when journal entries are made, that is, to flush costs backward to the points at which inventories remain.

Backflush costing refers to a variety of simplified cost accumulation methods that tend to be used by companies that adopt JIT systems. Most cost systems that include the backflush method are periodic inventory systems because perpetual inventory records are eliminated. Although a single cost system that includes the backflush method is relatively easy to understand, the topic is confusing because the backflush method can be used with any inventory valuation method. To understand the possibilities, consider that there are only four main ways to account for manufacturing costs at the end of a period. The first two possibilities represent the traditional inventory valuation methods, while the last two are non-traditional methods sometimes used by companies that adopt the JIT philosophy.

The four possibilities include:

1. Capitalize all manufacturing costs in the inventory as in full absorption costing. The applicable costs of direct materials, direct labour, variable overhead and fixed overhead are deferred in the ending inventory.

2. Capitalize only variable manufacturing costs in the inventory as in direct costing, i.e., charge fixed manufacturing costs to expense. Only the applicable direct materials, direct labour and variable overhead are deferred in the ending inventory.

3. Capitalize only direct materials costs in the inventory, i.e., charge all conversion costs to expense. Only the applicable direct materials costs are deferred in the ending inventory. This method is sometimes referred to as 'throughput costing' because it produces the same results that are obtained in the throughput accounting method associated with the theory of constraints.

4. Expense all manufacturing costs. No manufacturing costs are deferred in the inventory. This is the opposite of full absorption costing.

A variety of backflush systems can be designed for each of these four methods.

What is Backflush Costing?

Back flushing is nothing but automatic goods issue. System will automatically post the goods issue when you confirm the operations. There is no need to make manual issue. It will reduce the effort. Backflushing is automatic accounting of material consumed for production, at the time of confirmation of the production, e.g. when a 4-wheeler automobile is rolled out from assembly line, 4 wheels and tyres are deemed to be consumed and issued to production order automatically by way of backflushing by the system. The assembly line picks the material from Stores/Assembly line and use. No physical issue and manual posting of goods issue by Stores is made. Back flush is used for materials which are a must in the product and having fixed relationship with the product.

According to Business Dictionary. com—Method of costing a product that works backwards: standard costs are allocated to finished products on the basis of the output of a repetitive manufacturing process, used where inventory is kept at minimum (as in JIT operations) this method obviates the need for detailed cost tracking required in absorption costing and usually eliminates separate accounting for work-in progress.

Thus, "Backflush Costing is a method that works backward from the output to assign manufacturing cost to W.I.P. and inventories."

* B.Com (Hons), M.B.E., AICWAI, Assistant Professor, D.A.V. College Sec. 10, Chandigarh

Key Features

1. The term 'Backflush' is used because costs are flushed back through the production process to the point at which inventories remain.

2. Backflush Costing avoids detailed doing transactions as no separate accounts are maintained for W.I.P. in backflush accounting.

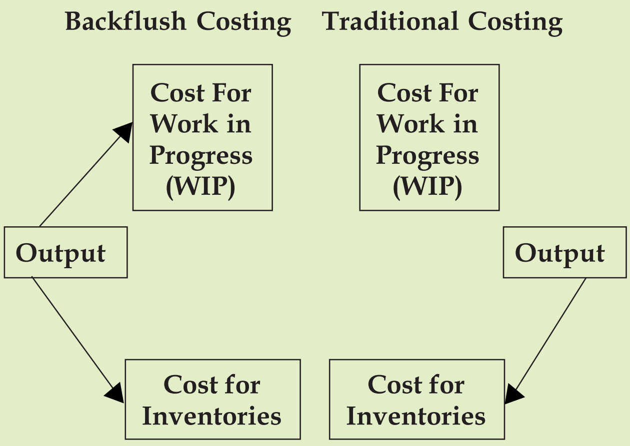
3. In backflush costing, first focus is on the output of the organization and it works backward to allocate costs between costs of goods sold and inventories.

Difference between Backflush Costing and Traditional Costing

Traditional normal and Standard Costing Systems use sequential tracking. Under sequential tracking, recording of journal entries follow the same order in which the four stages of purchases of materials, W.I.P., finished goods and sales take place.

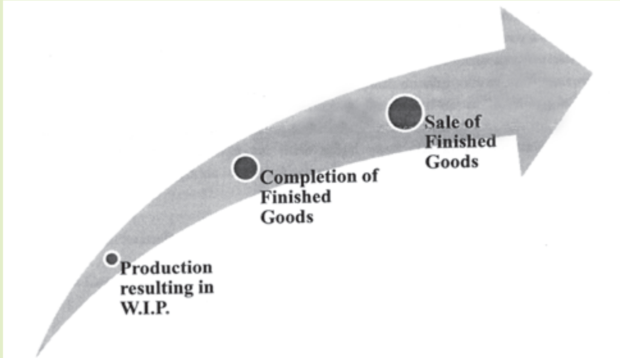
Backflush costing varies from traditional costing systems in that it does not track costs in order; instead it delays the recording of certain costs. The process used in backflush costing complements just-in-time (JIT) inventory systems by making the process of costing simpler. This type of costing system may be used to complement activity-based costing for the same reason. Although there are many variations of backflush costing, this type of costing generally eliminates the work-in-process account that is generally associated with most types of costing. Due to this and other variations from traditional costing methods, backflush costing may not be consistent with generally accepted accounting principles (GAAP), due to the fact that in most stages it may undervalue the inventory.

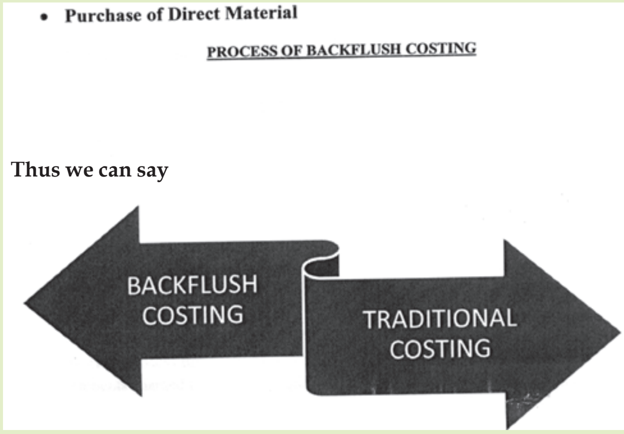
Comparison



Process of Backflush Costing

The process begins from the Stage A, i.e., Purchase of Direct Material followed by Stage B wherein actual production starts and work comes under progress. Finished Goods produced from Stage C followed by their sale, i.e., Stage D.





Procedures in Backflush Costing

The procedures in backflush costing may vary greatly from company to company, as there are various forms of this costing that can be used. Backflush costing may eliminate work-in-process accounts and instead flush all of the costs back at the end of the production run being costed. Backflush costing may also record raw materials at a standard cost when they are purchased, while recording conversion costs at their actual costs. Backflush costing is also used by eliminating the finished goods inventory account and, instead, recognize the finished goods at the point of sale.

How can Backflush Costing help?

Backflush Costing can simplify Traditional job costing systems by not recording journal entries for Work in process, purchase of Raw Material or production of Finished Goods.

How does it work?

1. All cost first accumulated in the cost of goods sold account.

2. At the end of accounting of Accounting period,

they are worked backward or flushed back, into the appropriate inventory accounts.

Cost flow through T Accounts

1. Direct material costs are charged directly to the cost of goods sold account.

2. Direct labour and Manufacturing Overhead Costs are combined in the Conversion costs account and transferred to the Cost of goods sold account.

3. Once all product costs for the period have been entered into the Cost of goods sold account, calculate the amounts to transfer back to the inventory accounts.

Calculating Amounts transferred back to Inventory Account

- Finished Goods Inventory Account
- Difference between cost of units sold and cost of completed units
- Work in Process Inventory Account
- Amounts charged to the Cost of goods sold Account during the period less the actual cost of goods finished during the period.

A term **"trigger point"** is used is used in backflush costing which means the stage where entries are to be made in books. Basically there can be two methods :

Trigger Points	Location of Entry
A. Two Trigger Points	A. (i) Purchase of raw material. (ii) Completion of finished goods. B. (i) Purchase of raw material. (ii) Sale of finished goods.
B. One Trigger Point	Completion of finished goods.

One point to be noted is that all conversion costs are recorded even in this method as per conventional costing system. In case of two trigger point system, conversion costs are allocated to products at trigger point 2. Moreover, under this system, under/over allocated conversion costs are written-off to Cost of goods sold monthly or at the end of year.

Journal Entries

Particulars	Debit (Dr.)	Credit (Cr.)
1. Inventory : Material & In-Process Control Conversion Costs Control To Various A/cs (such as wages payable)	××× ×××	 ×××
2. Finished Goods Control To Inventory : Materials & In-Process Control To Conversion Costs allocated	×××	 ××× ×××
3. Cost of Goods Sold A/c To Finished Goods Control	×××	 ×××
4. Conversion Cost allocated A/c Cost of Goods Sold A/c To Conversion Cost Control A/c	××× ×××	 ×××

Characteristics of Companies adopting Backflush Costing

The companies adopting backflush costing often meet the following three conditions:

1. Management wants a simple accounting system and no detailed tracking of direct material and direct labour through a series of operations is required.
2. Each product has a set of standard cost.
3. Material inventory levels are either low or constant.

If inventories are low, the bulk of manufacturing costs will flow into costs of goods sold and it is not deferred as inventory cost.

Backflush costing is especially attractive in companies that have low inventories resulting from JIT and to remove the incentive for managers to produce for inventory and make managers more focused on selling units.

When Is Backflush Costing Appropriate?

Backflush costing is most appropriate when used to complement a just-in-time inventory management system or to compliment an activity-based costing system. This is due to the fact that backflush costing simplifies the costing process in these situations. However, users of this type of system must keep in mind that it does not always conform to generally accepted accounting principles (GAAP) and that this type of system can be criticized because it does not leave a sequential audit trail.

In spite of these concerns, backflush costing may still be the most appropriate system for certain just-in-time inventory management situations. This is especially true if it is used in conjunction with activity-based costing.

It can be argued that backflush accounting simplifies costing since it ignores both labour variances and work-in-progress. Backflush accounting is employed where the overall cycle time is relatively short and inventory levels are low.

Backflush accounting is inappropriate when production process is long and this has been attributed as a major flaw in the design of the concept. ❐

THE INSTITUTE OF COST AND WORKS ACCOUNTANTS OF INDIA

(Established by an Act of Parliament)

12, Sudder Street, Kolkata - 700 016

Kolkata, the 13th June, 2011

NOTIFICATION

EL–2011/26 : The election to the Eighteenth Council of the Institute of Cost and Works Accountants of India was held in accordance with the Cost and Works Accountants (Election to the Council) Rules, 2006 as amended and as per the following Notifications :

1. Notification No. EL – 2011/1 dated 3rd March 2011
2. Notification No. EL – 2011/2 dated 3rd March 2011
3. Notification No. EL – 2011/5 dated 3rd March 2011
4. Notification No. EL – 2011/6 dated 3rd March 2011
5. Notification No. EL – 2011/7 dated 3rd March 2011
6. Notification No. EL – 2011/8 dated 3rd March 2011
7. Notification No. EL – 2011/9 dated 3rd March 2011

In pursuance of Rule 36 of the Cost and Works Accountants (Election to the Council) Rules, 2006 as amended and order of the Council of the Institute of Cost and Works Accountants of India, it is hereby notified for information that the following members have been declared elected to the Eighteenth Council of the Institute of Cost and Works Accountants of India for the term 2011– 2015 :

A. Western India Regional Constituency :

1. Apte, Amit Anand (M/16105)
   11/7, Laxminarayan Nagar, S. No. 11 & 12,
   Erandawane, Pune – 411 004.
2. Bhargave, Sanjay Ramchandra (M/8348)
   3, Khushboo Apartments,
   S. No. 78/2, Plot No. 29, Bhusari Colony (L), Paud Road,
   Kothrud, Pune – 411 038.
3. Bhattad, Pramodkumar Vithaldasji (M/6095)
   Dy. General Manager (Finance), South Eastern Coalfields Ltd., Seepat Road, Bilaspur – 495 006.
4. Soman, Aruna Vilas (M/6878)
   501, Vidya Apartments,
   168, Veer Savarkar Marg, Mahim, Mumbai – 400 016.

B. Southern India Regional Constituency :

1. Durga Prasad, A.S. (M/6922)
   M.D. & C.E.O., Propart Solutions India Pvt. Ltd.,
   4th Floor, Narmada Arcade, Above HDFC Bank,
   Nacharam Main Road, Hyderabad – 500 076.
2. Gopalakrishnan, M. (M/5927)
   1, Lakshmi Niwas, 3rd Street, K.V. Colony,
   West Mambalam, Chennai – 600 033.
3. Om Prakash, A. (M/11597)
   No. 3, 1st Main, 1st Cross,
   Kumaraswamy Layout II Stage,
   Bangalore – 560 078.
4. Rao, P.V.S. Jagan Mohan (M/7781)
   308, Himasai Gardens, Gulmohar Block,
   Jawahar Nagar, RTC Cross Roads,
   Hyderabad – 500 020.

C. Eastern India Regional Constituency :

1. Bandyopadhyaya, Sanjiban (M/8601)
   G–16, Banerjee Para, Kamdahari, Garia
   Kolkata – 700 084.
2. Mohanty, Suresh Chandra (M/10924)
   511, Sahid Nagar, Bhubaneswar – 751 007.
3. Srinivasa Prasad, T.C.A. (M/10996)
   Executive Director (F&A-ERP)
   Steel Authority of India Ltd.,
   SAIL House, 7th Floor,
   50, J.L. Nehru Road, Kolkata – 700 071.
4. Thakur, Manas Kumar (M/12867)
   22/4, Verner Lane, Belgharia,
   Kolkata – 700 056.

D. Northern India Regional Constituency :

1. Goel, Hari Krishan (M/14256)
   31, Community Centre, Ashok Vihar,
   Delhi – 110 052.
2. Gupta, Sanjay (M/18672)
   C–4–E/135, Janak Puri,
   New Delhi – 110 058.
3. Singh, Rakesh (M/10111)
   Pocket – C,
   211B, Siddhartha Extension,
   New Delhi – 110 014.

(Kaushik Banerjee)
Returning Officer

THE INSTITUTE OF COST AND WORKS ACCOUNTANTS OF INDIA

(Established by an Act of Parliament)

12, Sudder Street, Kolkata - 700 016

Kolkata, the 13th June, 2011

NOTIFICATION

EL–2011/27 : The elections to the four Regional Councils of the Institute of Cost and Works Accountants of India was held in accordance with the Cost and Works Accountants (Election to the Council) Rules, 2006 as amended, the Cost and Works Accountants Regulations, 1959 as amended and as per the following Notifications :

1. Notification No. EL – 2011/1 dated 3rd March 2011
2. Notification No. EL – 2011/3 dated 3rd March 2011
3. Notification No. EL – 2011/4 dated 3rd March 2011
4. Notification No. EL – 2011/5 dated 3rd March 2011
5. Notification No. EL – 2011/6 dated 3rd March 2011
6. Notification No. EL – 2011/7 dated 3rd March 2011
7. Notification No. EL – 2011/8 dated 3rd March 2011
8. Notification No. EL – 2011/9 dated 3rd March 2011

In pursuance of Rule 36 of the Cost and Works Accountants (Election to the Council) Rules, 2006 as amended read with Regulations 114, 115, 117, 118, 121 and other applicable Regulations of the Cost and Works Accountants Regulations, 1959 as amended and order of the Council of the Institute of Cost and Works Accountants of India, it is hereby notified for information that the following members have been declared elected to the four Regional Councils of the Institute of Cost and Works Accountants of India for the term 2011 – 2015 :

A. Western India Regional Council :

1. Birla, Dinesh Kumar (M/7907)
   A/3, Nirant Appartment, Opp. Town Hall,
   Near : Karnavati Hospital, Ellis – Bridge,
   Ahmedabad – 380 006.
2. Joshi, Neeraj Dhananjay (M/24118)
   CMA Pride, 1st Floor, Plot No. 6,
   S.No.1616, Erandawana Hsg. Soc.,
   Erandawana, Pune – 411 004.
3. Joshi, Vijay P. (M/22286)
   302, Sham Tower, 164/2, R.N.T. Marg,
   Near : Hotel President, Indore.
4. Mitra, Debasish (M/15379)
   B/502, Mayuresh Srishty Park,
   Off. Lake Road, Bhandup (W), Mumbai – 400 078.
5. Nawal, Ashok Bhagvandas (M/5720)
   A.B. Nawal & Associates, 203, Rohan Heights, D'Souza Colony, Off. College Road, Nasik- 422 005.
6. Paliwal, Ghanshyam R. (M/7815)
   G.R. Paliwal & Co., 408A, Lokmat Bhawan,
   Ramdaspeth, Wardha Road, Nagpur- 440 012.
7. Shah, Shrenik Sumantlal (M/6325)
   "Swashraya", 1-A, A.D.C. Bank Society,
   B/h. Sahajanand College, Ambawadi,
   Ahmedabad – 380 015.
8. Thatte, Ashish Prakash (M/27543)
   3, A/5, Anand Deep, Pendse Nagar,
   Dombivli (East) – 421 201.

B. Southern India Regional Council :

1. Iyer, Raju P. (M/6987)
   17 (Old No. 8), Hasthinapuram Main Road,
   Nehru Nagar, Chromepet, Chennai-600 044
2. Mayil Murugan, A. (M/20245)
   9, Kammalar Lane, North Car Street,
   Thirupparankundram, Madurai – 625 005.
3. Murugesan, J. (M/8400)
   17/1, Selvanagar Second Street,
   Ponnagar, Tiruchirapalli – 620 001.
4. Padmanabhan, H. (M/16200)
   Sr. Manager, Indian Overseas Bank,
   Sreekanteswaram Branch,
   Thiruvananthapuram – 695 023.
5. Prabhakar, B.R. (M/4630)
   No. 179, "Shubhodaya", 44th Cross, 8th Block,
   Jayanagar, Bangalore- 560 082.
6. Ramachandran, Srinivasan (M/4341)
   C/o Mr. Sakthi Kandappan, Investment Consultants, No 4, Office and Market Complex, No 4, 8th East Cross Road, Gandhi Nagar, Vellore – 632 006.
7. Rao, Sanyasi Kalavalapalli (M/16865)
   AGM (F & A), RINL, Vishakhapatnam Steel Plant,
   Vishakhapatnam – 530 031.
8. Subrahmanyam, G.V.S. (M/18713)
   Flat No 204, Shri Shailaja Nivas,
   Near Santoshimatha Temple,
   Bhavani Nagar, Dilsukhnagar, Hyderabad – 500 036.

9. Venkateswarlu, Ch. (M/10132)
Contracts Department,
Tata Projects Ltd, Mithona Towers,
Prenderghast Road, Secunderabad – 500 003.

C. Eastern India Regional Council :

1. Agarwal, Chitra (M/10441)
Room No. 303A, Deluxe Centre,
157C, Lenin Sarani, Kolkata- 700 013.
2. Bhattacharjee, Shyamal Kumar (M/5828)
8/4, S.P. Mukherjee Road,
Durgapur – 713 204.
3. Bhattacharya, Pallab (M/20372)
37, Gobindo Bose Lane,
Kolkata – 700 025.
4. Dasgupta, Saswata (M/21679)
8/4, Banerjee Para Road,
Behala, Kolkata – 700 060.
5. Mukhopadhyay, Ashok Kumar (M/11219)
14D/1B, Dum Dum Road,
Kolkata – 700 030.
6. Mukhopadhyay, Bibekananda (M/26671)
B – 20, Amarabati, Sodepur,
Kolkata – 700 110.
7. Padhi, Shiba Prasad (M/20719)
Plot No. N–1/163, IRC Village,
Nayapalli, Bhubaneswar – 751 015.
8. Sahoo, Srikanta Kumar (M/18217)
Qtrs No. D–32/F (2nd Floor)
GRIDCO Colony, P.O. – Bhoi Nagar,
Bhubaneswar – 751 022.

D. Northern India Regional Council :

1. Bhalla, Rakesh (M/9442)
H. No. 4551/C, Sector – 70,
SAS Nagar, Mohali – 160 059.
2. Bhatt, Sandeep Kumar (M/14652)
F – 103, DAV Complex,
Opp. Samachar Apptt,
Mayur Vihar – 1, New Delhi – 110 091.
3. Jain, Baboo Lal (M/6218)
General Manager (F & A),
MMTC Ltd, Core – I,
Scope Complex, Lodi Road,
New Delhi – 110 003.
4. Kumar, Arvind (M/25573)
Manager - Accounts, IFFCO,
2/10 Kali Mandir Enclave,
Dehradun.
5. Sahni, Ravi Kumar (M/16339)
408, 1st Floor Shakti Khand – IV,
Indira Puram, Ghaziabad – 201010
6. Sharma, Vijender (M/18513)
11, (3rd Floor) Hargovind Enclave,
New Delhi – 110 092.
7. Srivastava, Saurabh (M/13771)
IRCON International Ltd,
Plot No – 22, EcoTech – III,
Udyog Kendra, Greater Noida – 201 306.

(Kaushik Banerjee)
Returning Officer

THE INSTITUTE OF COST AND WORKS ACCOUNTANTS OF INDIA

(Established by an Act of Parliament)

12, Sudder Street, Kolkata - 700 016

Kolkata, the 23rd June, 2011

NOTIFICATION

18-CWR (1614)/2011 : It is hereby notified in pursuance of Regulation 18 of the Cost and Works Accountants Regulations, 1959, that in exercise of the powers conferred by Regulation 17 of the said Regulations, the Council of the Institute of Cost and Works Accountants of India has restored to the Register of Members, the name of :

1. Shri Raghunath Ghosh (M/5529), B.Com., ACS, AICWA, Vill. Goai, P.O. Amra, Dist. Hooghly - 712149 with effect from 1st June, 2011

Sd/-
(Brijmohan M. Sharma)
President

Kolkata, the 14th July, 2011

NOTIFICATION

16-CWR (8808)/2011 : In pursuance of Regulation 16 of the Cost and Works Accountants Regulations, 1959, it is hereby notified that in exercise of powers conferred by sub-section (2) of of Section 20 of the Cost and Works accountants Act, 1959, the Council of the Institute of Cost and Works Accountants of India has removed from the Register of Members, the name of Shri Pawan Kumar Verma, BCom, FICWA, Pawan & Associates, 2nd Floor, Bajaj Building, Upstairs Dr. Bowry Clinic, Bazar Panj Peer, Near Bhagat Singh Chowk, Jalandhar City-144 001, (Membership No. 13570) from 14th July, 2011 to 13th July, 2012 in respect of whom an order has been passed under sub-section (3) of Section 21B by the Disciplinary Committee.

Sd/-
(Brijmohan M. Sharma)
President

Health Checks at discounted rates for ICWAI family—MOU with SRL

Super Religare Laboratories (SRL) has been since its inception, promoting the cause of medical diagnostics in India by ushering in the most specialized technologies and innovative services. With its extensive network of laboratories, SRL continues to revolutionize the diagnostic services in this country. ICWAI now join hands with SRL by entering into an MOU for a comprehensive health check up plan as well as diagnostics for ICWAI members, students, employees and their families at special discounted rates. To avail of this facility, the members, students, employees and their family members of ICWAI will have to show their ID cards at the SRL centres which will be issued by ICWAI. Additionally, onsite health camps will be organized by SRL across all ICWAI locations in the country so that the ICWAI family keep themselves in the pink of their health. The MOU between ICWAI and SRL will extend a comprehensive health check up plan for the ICWAI family at a discounted rate of 50% on specially customized "Wellness Packages" as well as discounts on all diagnostic tests which will ensure better health management to all. Further details will be available on the website shortly.

F. No. 52/26/CAB-2010
Government of India
Ministry of Corporate Affairs

Cost Audit Branch

B-1 Wing, 2nd Floor,
Paryavaran Bhawan,
CGO Complex, Lodhi Road,
New Delhi-110 003

Dated the 30th June, 2011

ORDER

Consequent upon notification of the Companies (Cost Accounting Records) Rules, 2011 published vide G.S.R. 429(E) dated 3rd June 2011 and in modification of the earlier Order of even number dated 3rd May 2011, the Central Government hereby makes the following Order.

In exercise of the powers conferred by sub-section (1) of section 233B of the Companies, Act, 1956 (1 of 1956), the Central Government, being of the opinion that it is necessary to do so, hereby directs that all companies to which the Companies (Cost Accounting Records) Rules, 2011 apply, and which are engaged in the production, processing, manufacturing or mining of the following products/activities, including intermediate products and articles or allied products thereof, and wherein the aggregate value of the turnover made by the company from sale or supply of all products or activities during the immediately preceding financial year exceeds hundred crores of rupees; or wherein the company's equity or debt securities are listed or are in the process of listing on any stock exchange, whether in India or outside India, shall get its cost accounting records, in respect of each of its financial year commencing on orr after the 1st day of April, 2011, audited by a cost auditor who shall be, either a cost accountant or a firm of cost accountants, holding valid certificate of practice under the provisions of Cost and Works Accountants Act, 1959 (23 of 1959).

S. No.	Name of the Industry	Relevant Chapter Heading of the Central Excise Traiff Act, 1985
1.	Cement	Chapter 25, 38 and 68
2.	Tyres & Tubes	Chapter 40
3.	Paper	Chapter 47 and 48
5.	Insecticides*	Chapter 38
6.	Glass	Chapter 70
7.	Paints & Varnishes	Chapter 32
8.	Aluminum	Chapter 76

Note : Intermediate products and articles or allied products of above industries if included under any other Chapter of the Central Excise Traiff Act, 1985 not mentioned above shall also be covered under these orders.

**Includes all classes of Insecticides as defined under clause (e) of Section 3 of the Insecticides Act. 1968 (46 of 1968) and included in the schedule annexed to the said Act and as amended from time to time.*

2. Every company to which these orders apply shall follow the revised procedure for appointment of cost auditor as laid down vide Ministry of Corporate Affairs' General Circular No. 15/2011 [52/5/CAB-2011] dated 11th April 2011. For companies covered first time under these modified orders and wherein their financial year has already commenced between the 1st day of April, 2011 and the date of these orders, the period of ninety days for e-filling their applications with the Central Government in the prescribed form 23C for appointment of cost auditors shall be counted from the date of these orders.

3. The audit shall be conducted in such manner as will enable the cost auditor to prepare the report in accordiance with the Companies (Cost Audit Report) Rules, 2011 published vide G.S.R. 430(E) dated 3rd June 2011. The report of the cost auditor shall be forwarded to the Central Government in the prescribed format within the time stipulated under the said Rules.

4. These orders do not apply to a company which is a body corporate governed by any special Act.

5. All companies covered by these orders and wherein cost audit orders have been issued so far in respect of products/activities covered by any or all of the Cost Accounting Records Rules as they existed before their supersession by the Companies (Cost Accounting Records) Rules, 2011 published vice G.S.R. 429(E) dated 3rd June 2011 shall continue to comply with the said orders until these orders become applicable on them.

6. If a company contravenes any provisions of these orders, the company and every officer thereof who is in default, including the persons referred to in sub-section (6) of section 209 of the Companies Act, 1956, shall be punishable as provided under sub-section (2) of section 642 read with sub-section (11) of sectidon 233B of the Companies Act, 1956 (1 of 1956)

(B. B. Goyal)
Adviser (Cost)

ANNOUNCEMENT

The Management Accountant —September, 2011 will be a special issue on **'CMAs IN HOSPITALITY MANAGEMENT'.** Articles, views and opinions on the topic are solicited from readers to make it a special issue to read and preserve. Those interested may send in their write-ups by e-mail to rnj.sumita @icwai.org, followed by hard copy to the Research & Journal Department, 12 Sudder Street, Kolkata-700016 to reach by 15th August, 2011.

The Management Accountant — October, 2011 will be a special issue on **'BEHAVIOURAL FINANCE'.** Articles, views and opinions on the topic are solicited from readers to make it a special issue to read and preserve. Those interested may send in their write-ups by e-mail to rnj.sumita @icwai.org, followed by hard copy to the Research & Journal Department, 12 Sudder Street, Kolkata-700016 to reach by 15th September, 2011.

The Management Accountant — November, 2011 will be a special issue on **'CMAs IN SERVICE SECTOR'.** Articles, views and opinions on the topic are solicited from readers to make it a special issue to read and preserve. Those interested may send in their write-ups by e-mail to rnj.sumita @icwai.org, followed by hard copy to the Research & Journal Department, 12 Sudder Street, Kolkata-700016 to reach by 15th October, 2011.

Admission to Membership

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Date of Advancement : 24th December 2010

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MANAGEMENT DEVELOPMENT PROGRAMMES 2011-12

THE INSTITUTE OF COST AND WORKS ACCOUNTANTS OF INDIA

(Set up under an Act of Parliament)

Management Development Programmes 2011-12

Dates	Topic	Venue	Status & Fee (Rs.)	
			Non-Residential	
	August, 2011			
03 - 05	Management of Taxation – Service Tax, VAT, Excise & Customs, TDS and Proposed GST & DTC	Kolkata	15,000	33,000
09 - 12	Finance for Jr. Finance and Accounts Officers and Non-Executives (F & A)	Madurai		33,000
09 - 12	Advance Tax, TDS & Tax Planning	Madurai		33,000
18th	Proposed DTC	New Delhi	4,000*	
19th	Proposed GST	New Delhi	4,000*	
24 - 28	Certificate Course on IFRS and Converged Indian Accounting Standards	Hyderabad		
	September, 2011			
06 - 09	Internal Auditing for Effective Management Control	Port Blair		35,000
06 - 09	Recent Trends in Financial Management including IFRS and new Schedule VI of Companies Act.	Port Blair		35,000
21 - 25	Certificate Course on IFRS and Converged Indian Accounting Standards	Bangalore	25,000	
22nd	Proposed DTC	Chennai	4,000*	
23rd	Proposed GST	Chennai	4,000*	
	October, 2011			
18 - 21	Contract Management	Goa		33,000
18 - 21	Corporate Tax-Planning, Compliance and Management	Goa		33,000
	November, 2011			
02 - 06	Certificate Course on IFRS and Converged Indian Accounting Standards	Kolkata	25,000	
15 - 18	Advance Tax, TDS & Tax Planning	Hyderabad	15,000	33,000
15 - 18	Recent Trends in Financial Management including IFRS and new Schedule VI of Companies Act.	Hyderabad	15,000	33,000
15 - 25	International Programme on 'Emerging Trends in Financial Management.	Singapore Kualalumpur & Bangkok		2,50,000
	December, 2011			
13 - 16	Finance for Jr. Finance and Accounts Officers and Non-Executives (F & A)	Shirdi		33,000
13 - 16	Management of Taxation – Service Tax, VAT, Excise & Customs, TDS and Proposed GST & DTC	Shirdi		33,000
22nd	Proposed DTC	Kolkata	4,000*	
23rd	Proposed GST	Kolkata	4,000*	
	January, 2012			
03 - 06	Internal Auditing for Effective Management Control	Mahabaleshwar		33,000
03 - 06	Recent Trends in Financial Management including IFRS and new Schedule VI of Companies Act.	Mahabaleshwar		33,000
5th	Proposed DTC	Hyderabad	4,000*	
6th	Proposed GST	Hyderabad	4,000*	
17 - 20	Strategic Financial Management	Agra		33,000
17 - 20	Advance Tax, TDS & Tax Planning	Agra		33,000

Dates	Topic	Venue	Status & Fee (Rs.)	
			Non-Residential	Residential
	February, 2012			
09 - 10	Valuation Management	New Delhi	15,000	
21 - 24	Corporate Tax–Planning, Compliance and Management	Bhubaneshwar		33,000
21 - 24	Strategic Cost Management	Bhubaneshwar		33,000
23 - 24	Financial Risk Management	New Delhi	15,000	

Note : * Rs. 7000/- if any nomination is for both the programmes together.

For Non-Residential Programmes — **Fee includes course fee, course material, lunch, tea/ coffee etc.**

For Residential Programmes — **Fee includes course fee, course material, accommodation on Single Room basis, all meals and visits. The charges for accompanying spouse would be Rs. 1000/- (Rupees one thousand only) towards accommodation, all meals and visits for all the three days excluding International programmes.**

CEP Credit Hours — [For 1 Day Prog. – 4 Hours] [For 2 Days Prog. – 6 Hours] [For 3 Days more Prog. – 10 Hours]

For Kind Information

- For outstation programmes the participants are requested to get the confirmation from the Institute before proceeding to the venue. If any participant reaches the venue for the postponed/cancelled programme without getting the confirmation from the Institute, the Institute will not be held responsible for the same. The cancellation/postponement of the programme, if any, will be intimated to only those organizations whose nominations have been received by the Institute on time.
- For residential programmes normally the first day check-in at 12.00 noon and last day check-out at 12.00 noon.
- For International programmes, Faculty will be from the respective countries apart from the Indian Faculty.
- The Payment of the Fee is to be made by Cheque / DD in favour of 'The Institute of Cost and Works Accountants of India' payable at New Delhi.
- Details for ECS Payment: State Bank of India (60321), Andhra Association Building, Institutional Area, Lodhi Road, New Delhi -110003 Current A/c No.: 30678404793 MICRCode : 110002493 IFSCCode : SBIN0060321

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President
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For Attention of Members

Payment for Annual Membership Fee for 2011-2012

The Annual Membership Fee for 2011-2012 for all Associate and Fellow Members of the Institute has become due and payable on 1st April, 2011 at the following rates:

Associate Annual Membership Fee : Rs.500/- (Rs. 125/- for members entitled to pay at reduced rate)
Fellow Annual Membership Fee : Rs.1000/- (Rs.250/- for members entitled to pay at reduced rate)

All members are requested to pay their respective membership fees along with arrears, if any, immediately and **not later than 30th September, 2011**.

The fees may be paid by Cash/Demand Draft/Cheque at the Headquarters/Regional Council offices/ Chapters of the Institute. The Demand Draft/Cheque should be drawn in favour of "The ICWA of India" and payable at Kolkata. In case of outstation cheque Rs. 30/- is to be added towards Bank Charges.

NOTE : MEMBERS SHOULD ENSURE TO INDICATE THEIR NAME AND MEMBERSHIP NO. ON THE REVERSE OF CHEQUE/DEMAND DRAFT TO BE DRAWN IN FAVOUR OF "THE ICWA OF INDIA" PAYABLE AT KOLKATA IN CASE PAYMENT IS RENDERED BY CHEQUE/DEMAND DRAFT, IT SHOULD ALSO BE ENSURED NOT TO ENCLOSE ANY OTHER INTIMATION ETC. ALONG WITH THE REMITTANCE OF MEMBERSHIP FEE.