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YEARS OF CELEBRATING THE MAHATMA

CMA Student E - Bulletin

FINAL

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150 YEARS OF CELEBRATING THE MAHATMA

THE INSTITUTE OF COST ACCOUNTANTS OF INDIA

CONTENTS

150 YEARS OF CELEBRATING THE MAHATMA

KNOWLEDGE
Update

In this section of e-bulletin we shall have a series of discussion on each of these chapters to provide a meaningful assistance to the students in preparing themselves for the examination at the short end and equip them with sufficient knowledge to deal with real life complications at the long end.

GROUP: iii, PAPER: 13

CORPORATE
LAWS & COMPLIANCE (CLC)

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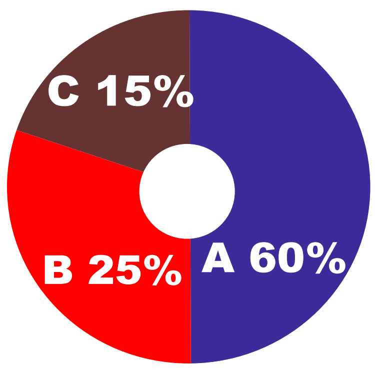
Your Preparation Quick Takes



Syllabus Structure
A Companies Act **60%**
B Other Corporate Laws **25%**
C Corporate Governance **15%**

Learning Objectives:

Read the Study Material minutely.

- For details or if you don't understand Study Material or the section is important to identify the topic, then refer to Bare Act, otherwise reference to Bare Act is not necessary. For Company Law, book by Avtar Singh is recommended. For other laws Institute Study Material is sufficient.
- The words used in any of the texts as mentioned above should be understood by immediate reference to the Dictionary.
- The main points coming out in any of the provisions should be either underlined or written in separate copy which has to be repeated again and again.
- Theoretical knowledge should be adequate and clear before solving practical problems.
- Don't write wrong English. It changes the meaning and therefore answer may be wrong even when the student's conception is clear. Also don't make spelling mistakes.

AUDIT AND APPPOINTMENT OF AUDITORS

1. Meaning of Audit.

An audit is the independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon.

2. qualification of an auditor

The following entities can be appointed as an auditor of the company.

(a) A chartered Accountant in practice within the meaning of Chartered Accountants Act, 1949.
(b) A firm where all the partners practicing in India as Chartered Accountants.
(c) A holder of certificate in part B State entitling him to act as an Auditor of companies.

3. Disqualification of an Auditor [section 141(3)]

The following persons shall be disqualified from being appointed as Auditors of a company:

(i) A person who by himself, or his relative or partner –

(d) Is holding any security of the company or its subsidiary, or of its Holding or Associate Company or a subsidiary of such Holding Company. (Provide the relative may hold security or interest of not more than one lakh in the company).
(e) is indebted to the company or its Subsidiary, or its Holding or Associate Company or a Subsidiary of such Holding company in excess of such amount as may be prescribed.
(f) has given a guarantee or provided any security in connection with the indebtedness of any third person to the Company, or its Subsidiary, or its Holding or Associate Company or a Subsidiary of such holding company for such amount as may be prescribed;

(i) a person or a firm who whether directly or indirectly has business relationship with the Company, or its Subsidiary, or its Holding or Associate Company or Subsidiary of such holding company or associate company of such nature as may be prescribed;
(ii) a person whose relative is a director or is in employment of the company as a director or Key Managerial Personnel.
(iii) A person who has been convicted by a Court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction.

4.Number of audits [section 141(g)]

The specified number of audit which one auditor can undertake is 20 companies out of which not more than 10 companies shall have the paid up capital of rupees twenty five lakhs or more. The aforesaid restriction is not applicable to One Person Company, Private Companies and small companies. However, the following audits of such auditor shall not be taken into account for computing the aforesaid limit:

(a) Audit of an private company.
(b) Audit of a guarantee company having no share capital.
(c) Audit of a foreign company.

(d) Internal audit undertake by him.
(e) Audit of a co-operative society, trust and corporations that do not fall within the ambit of the Companies Act, 1956.
(f) Tax audits.
(g) Special audits and investigations.
(h) A branch audit.

A certificate is to be given by the Auditors to the Registrar as to satisfaction of the above stipulation and compliance of other provisions and rules relating to appointment of Auditors.

5. Appointment of First auditors [section 139(1) & 140(1)]

(1) Shall be appointed by the Board of Directors within one month of the registration and on failure to do so the members shall appoint the auditors within 90 days of the incorporation of the company.
(2) Shall hold office until the conclusion of the 1st AGM.
(3) Notice of appointment should be given by the company to the auditor and the Registrar within 15 days of the appointment of the Auditor.
(4) Shareholders can remove the 1st auditors before the conclusion of the 1st AGM by passing a special resolution and after obtaining the previous approval of Central Govt.

6. Appointment of subsequent auditors [section 139 & 140]

(1) Appointment to be made in the AGM by the shareholders.
(2) Shall hold the office from the conclusion of the first Annual General Meeting till the conclusion of its 6th Annual General meeting and thereafter till the conclusion of every 6th meeting.

No listed company and any other company as may be prescribed by the act shall appoint or re-appoint

(i) an individual as Auditor in the same company for more than one term of 5 consecutive years.
(j) An audit firm as auditor for more than two terms of five consecutive terms.

(3) After appointment the company shall intimate such information to the Auditors and Registrar within 15 days of the appointment of the Auditor.
(4) Company can remove the auditors after obtaining the approval from the Central Govt. and with the permission of shareholders by way of a special resolution.

7. Automatic re-appointment of retiring auditors [section 139(9)].

Subject to the provisions and rules there under the retiring auditors shall be reappointed automatically at an Annual General meeting except in the following cases:

(a) Where he is not disqualified for re-appointment.
(b) Where he has not given the company or expressed his unwillingness to be re-appointed and act as an auditor.
(c) A special resolution has not been passed to appoint some other auditor or providing expressly that he shall not be re-appointed.

8. Appointment of auditors in casual vacancy [section 139(8)].

(1) Shall be filled up by the Board of Directors except in the case where the casual vacancy is due to resignation of the auditor from the office. In such a case the casual vacancy shall be filled up by the shareholders in the general meeting held within 3 months of the recommendation of the Board.
(2) During the vacancy co-auditors to continue audit.
(3) Auditor appointed in the casual vacancy shall hold office until the conclusion of the next AGM.

9. Remuneration to auditors

(1) The Remuneration payable to an auditor shall be fixed by the shareholders in its general meeting.
(2) The Board of Directors may fix by the remuneration of the first auditor appointed by it.
(It shall not include any expense incurred by the auditor in connection with the audit or any facility given to him by the company in connection with the audit and any remuneration for any service rendered by him to the company for any service at the request of the company.

10. Cost Audit (section 148)

Cost audit when required.

(1) The company is engaged in production, processing, manufacturing or mining activities.
(2) The company pertains to the class of companies that are required by the Central Government to maintain the cost records.
(3) An order is issued by the Central Government directing the company to conduct cost audit.
(4) Under the new Act the Central Govt. can direct particulars relating to utilization of material or labour or such other items of cost to be included in books of accounts by such class of companies which are engaged in production of goods or providing such services.
(5) The cost audit is required only for that particular year in respect of which the cost audit order has been issued.

11.Internal Audit (Section 148)

(i) The following categories of companies shall appoint a Chartered Accountant or a Cost Accountant or any other person decided by the Board as Internal Auditor.

12.Auditor not to render other services

Auditors will not take up the following services directly or indirectly to the company or its holding or subsidiary company.

(a) Accounting and book keeping services;
(b) Internal audit;
(c) Design and implementation of any financial information system;
(d) Actuarial services;
(e) Investment advisory services;
(f) Investment banking services
(g) Outsourced financial services;
(h) Management services;

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STRATEGIC FINANCIAL MANAGEMENT (SFM)

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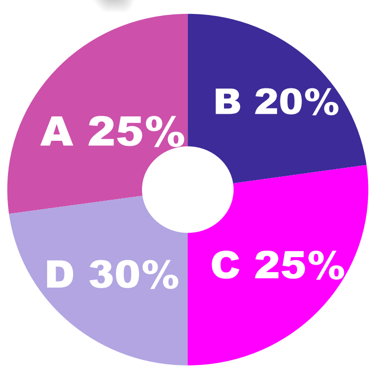
Your Preparation Quick Takes



Syllabus Structure

A Investment Decisions **25%**
B Financial Markets and Institutions **20%**
C Security Analysis and Portfolio Management **25%**
D Financial Risk Management **30%**

Learning objectives:

After studying this section on Strategic Financial Management, you will be able to:

- understand the direct and indirect quotations
- know the European terms and American terms

Section C & Study Note 8: Security Analysis and Portfolio Management

- **Technical Analysis**
- **Some Widely Used Price Patterns and Their Interpretation (contd…)**

6. Flags

If a vertical rally or a decline is interrupted by a consolidation pattern akin to a rectangle, such a formation is called a flag. After the flag formation, prices move in the same direction as before. Flags only represent a pause in a rally or reaction before prices continue in their course. Flags may be horizontal, though it has been found that flags in a rising market are formed with a slight downtrend, and flags in a falling market have a slight uptrend.

Volume is generally very high as the flag begins to form and tapers off when the formation is complete. When the prices breakout of the flag, a sudden increase in volume can be noticed. In a rising market, bullish traders may pause to register gains in the course of an uptrend that is particularly sharp, causing a flag formation in prices.

A pennant is similar to a flag in all respect except that it looks like a triangle rather than a rectangle. The volumes accompanying a pennant formation are much smaller, and contract more than during a flag formation.
Consider the following figures:

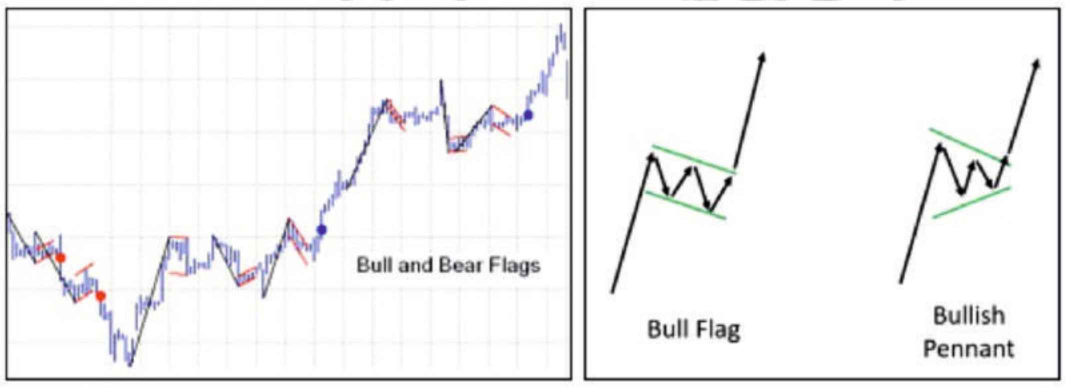


Figure 6 and 7: Flags and Pennants

7. Saucers and Rounding Tops

A saucer generally occurs at market bottoms when the investor's interest in the share is at its lowest ebb. The lows reached at the end of the market are all formed by reactions that are small, and rallies are not marked enough due to lack of enthusiasm. However, these minor fluctuations while continuing for some time, form a saucer-like pattern indicating that fluctuations have been occurring at higher price levels, after a bottom was reached. This triggers an increase in price as well as volume, which explode at the end of the formation to a smart rally.

In case of a saucer being formed during a period of near inaction in the market, volumes almost dry up at the bottom of the saucer and pickup once the upward movement in prices begins. Saucers, sometimes, are formed when the rally in the beginning of a bull market is sluggish, and have the same characteristics as described above. In such cases, saucers confirm a reversal.

A rounding top is exactly opposite to a saucer, but volume characteristics are same for both the patterns. A rounding top is formed to indicate a slow change in the demand-supply balance, and is an important reversal pattern.

The price volume relationship in a rounding top formation provides important tips. The volume behaves just opposite to the price pattern, resulting in tow volume when the price is at the highest level, and expanding volumes when prices begin to fall. As seen in the section on volumes, both of these indicate a downtrend in prices.
Consider the following diagrams.

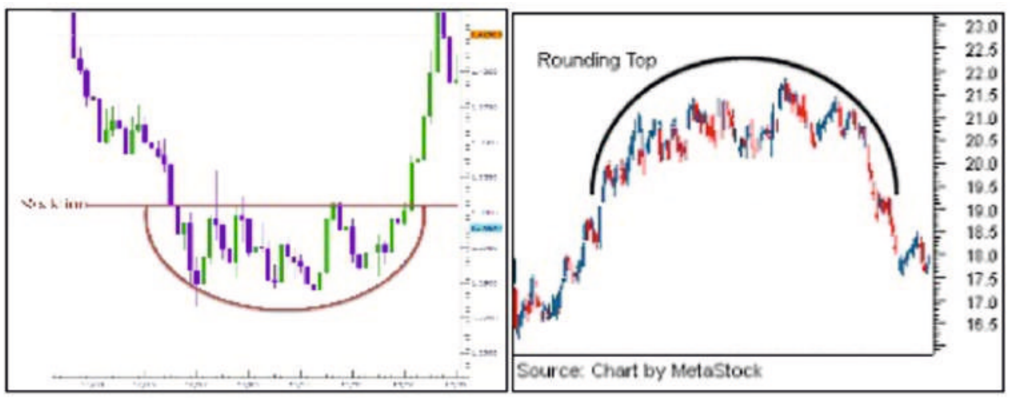


Figure 8 and 9: Saucers and Rounding Top

8. Gaps

A gap is an empty space between one price bar and the next. Gaps occur when the price significantly changes from the close of one price bar to the next, with no trading taking place in the empty space between the bars.
There are four types of gaps: common, breakaway, runway and exhaustion, as well as gap pattern known as island reversal.
Consider the following diagram:

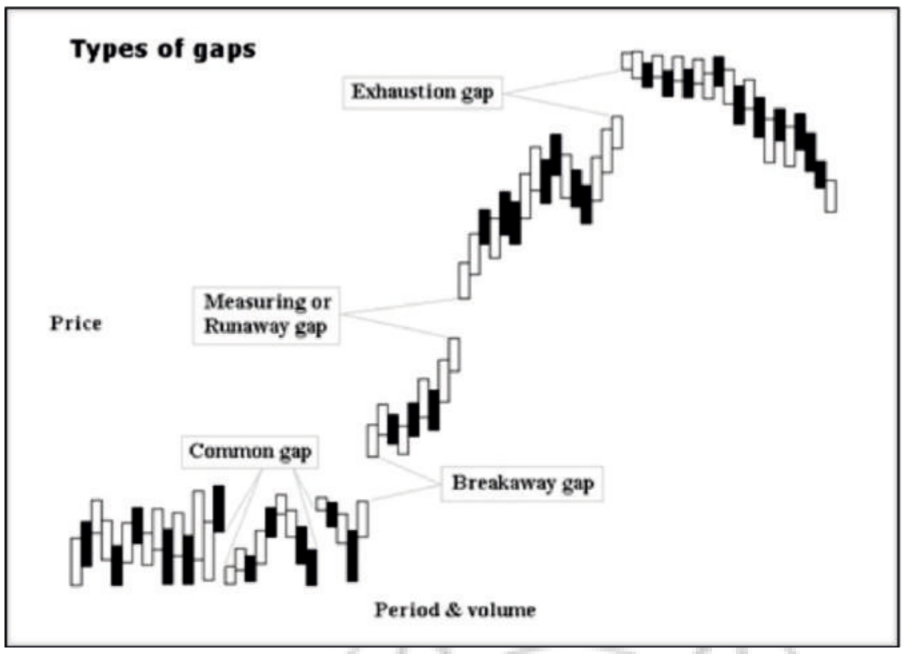


Figure 10: Different Types of Gaps

9. Rising and Falling Wedges

Wedges are characterized by prices fluctuating between two converging boundary lines. In the case of a rising wedge, the boundary lines slope upward with the lower line being at a steeper angle than the upper line. In the case of a falling wedge, the boundary lines slope down and the upper line is at a steeper angle than the lower Hne. Usually, breakouts occur, at least two-thirds of the way to the apex of the converging boundary lines.

Wedges are formed on a regular basis and trading volume in a wedge gradually diminishes as prices move towards the apex of the wedge and then rises on the breakout. From a technical point of view, a rising wedge implies a situation that is growing weaker. When prices break through the lower line of a rising wedge, they usually fall intensely. Sell signals, which are generated by breakouts below the lower line of rising wedges, are more reliable than in bull markets. Falling wedges depict a situation that gets stronger from a technical perspective. When prices break from the upper boundary of a falling wedge, they tend to move sideways for a certain period before they begin to rise.

Consider the following diagram:

Figure 11: Rising and Falling Wedges

10. 'V' Formation

As the name indicates, in the 'V' formation, there is a long sharp decline and a fast reversal. The 'V' pattern occurs mostly in popular stocks where the interest changes quickly from hope to fear and vice-versa. In the case of an inverted 'V', first rise occurs and then decline. There can also be extended 'V's. In such a case, the bottom or top moves slowly over a broader area. This is shown below:

Figure 12: 'V' formation

- **Trendlines**

A rising primary trend in prices would be marked by a series of ascending rallies, while a falling trend would be characterized by a series of descending rallies. Trendlines are lines that are drawn to identify such trends and extend them into the future. These lines typically connect the peaks of rallies and bottoms of reversals. Sometimes, an intermediate trend that extends horizontally, is seen. Trendlines can also be drawn to describe such patterns. The boundaries of a rectangle can be called a horizontal trendline.

Penetration of a trendline may either mean a reversal or a consolidation. In other words, after a price chart breaks out of the trendline a reversal in the previous trend may occur, or the same trend may be continued. Trendlines have to, therefore, be analysed along with the price patterns discernible on the chart. The neckline of head and shoulders pattern can be seen as a horizontal trendline, while penetration signals reversal. Similarly, penetration of a trendline that joins the troughs of a right-angled triangle formation indicates a reversal. Trendline violation can be further analysed with the help of volume statistics that accompany it. A bullish trend can be recognized to be near its end, if volumes at each successive rally are on the decrease. A trendline penetration in such circumstances can signal a reversal.

Consider the following diagram:

Figure 13: Trendlines

- **Trend Channels**

Trendlines encompass rallies or reactions by joining successive tops or bottoms. Sometimes, it is useful to 'trap' trends by drawing trendlines on both the sides of an uptrend or a downtrend. These parallel lines drawn to encompass trends from both the sides are called channels.

Penetration of an up channel indicates a reversal of at least a temporary proportion, because it confirms that the price line not only fails to reach the previous rally, but also reaches a new low, below the previous troughs. The reverse is true for penetration of a down channel. Consider the following diagram:

Figure 14: Trend Channel

- **Support and Resistance Levels**

Both support and resistance levels are an integral part of technical analysis. A support level exists at a price where considerable demand for that stock is expected to prevent a future fall in the price level. The fall in the price may be halted for the time being, or it may even result in a price reversal. In the support level, the demand for the scrip is expected to remain

In the resistance level, the supply of the scrip is greater than the demand and a further rise in price is prevented. The selling pressure is greater, and the increase in price is halted for the time being. When the stock touches a certain level and drops, this is called resistance, and if the stock goes down to a certain level and then rises, there exists a support.

If the script prices break the support level and moves downward it means that the selling pressure has overcome the potential buying pressure, signaling the possibility of a further fall in the value of the script. It indicates the violation of the support level and a bearish market.

If the script penetrates the previous top and moves above it is a violation of the resistance level. At this point the buying pressure would be more than the selling pressure. If the script moves above the double top or triple top formation it indicates a bullish market. The support and resistance levels need not be formed only on top or bottom, they can be on the trend lines or gaps of the chart.

Figure 15: Support and Resistance

GROUP: iii, PAPER: 15

STRATEGIC

COST MANAGEMENT-DECISION MAKING (SCMD)

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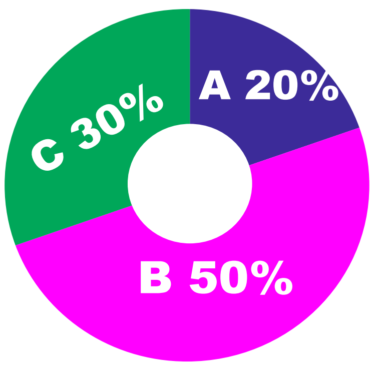
Your Preparation Quick Takes



Syllabus Structure

A Cost Management **20%**
B Strategic Cost Management Tools and Techniques **50%**
C Strategic Cost Management - Application of Statistical Techniques in Business Decisions **30%**

Learning Objectives:

The Strategic cost management framework provides a clear plan of attack for addressing costs and decisions that affect them. It helps to get answers on:

- Is there a plan for strategic cost management?
- Have the controlling functions for each significant cost in the organization been identified?
- Are there resources devoted to finding or obtaining new approaches to breaking cost barriers?
- Is cost modelling being used or is there an active effort to develop or buy cost modelling capability?

Study Note 6: Application of Operation Research and Statistical Tools in Strategic Decisions Making

➢ **Linear Programming Problem**

- ***General Mathematical Model of Linear Programming Problem***

The general linear programming problem (or model) with *n* decision variables and *m* constraints can be stated in the following form:

Optimize (Max. or Min.) $Z = c_1x_1 + c_2x_2 + \ldots\ldots\ c_nx_n$

subject to the linear constraints,

$a_{11}x_1 + a_{12}x_2 + \ldots\ldots + a_{1n}x_n\ (\le, =, \ge)\ b_1$

$a_{21}x_1 + a_{22}x_2 + \ldots\ldots + a_{2n}x_n\ (\le, =, \ge)\ b_2$

……………………………………………

…………………………………………….

$a_{m1}x_1 + a_{m2}x_2 + \ldots\ldots + a_{mn}x_n\ (\le, =, \ge)\ b_m$

and $x_1, x_2, x_3 \ldots\ldots\ldots\ x_n \ge 0$

- **Steps in Linear Programming Model Formulation**

The effective use and application of LPP technique requires, as a first step, the mathematical formulation of an LP model.
The steps in LP model formulation are summarized as follows:

Step 1: Identify the decision variables

(a) Express each constraint in words. For this one should first see the type of the constraint which may be of the form ≥ (at least as large as), of the form ≤ (no larger than) or of the form = (exactly equal to).
(b) Express verbally the objective function.
(c) Verbally identify the decision variables with the help of Step (a) and (b).

Step 2: Identify the problem data

Now, to formulate an LP model, identify the problem data in terms of constants and parameters associated with decision variables. It may be noted that the decision-maker can control values of the variables but cannot control values in the data set.

Step 3: Formulate the constraints

Convert the verbal expression of the constraints in terms of resource requirement and availability of each resource. Then express each of them as linear equality or inequality, in terms of the decision variables defined in Step 1.
Values of these decision variables in the optimal LP problem solution must satisfy these constraints in order to constitute an acceptable (feasible) solution. Wrong formulation can either lead to a solution that is not feasible or to the exclusion of a solution that is actually feasible and possibly optimal.

Step 4: Formulate the objective function

Identify whether the objective function is to be maximized or minimized. Then express it in the form of linear mathematical expression in terms of decision variables along with profit (cost) contributions associated with them.

Step 5: Express the formulation in a summarized form

Finally, express the LP formulation in summarized mathematical form clearly stating each part of the LPP i.e., the objective function with specification as to whether it is to be maximised or minimised, the functional constraints and last but not the least the non-negativity constraints.

- **Some Illustrations on LPP Formulation**

Illustration 1

An electronic company is engaged in the production of two components C1 and C2 that are used in radio sets. Each unit of C1 costs the company Rs 5 in wages and Rs 5 in material, while each of C2 costs the company Rs 25 in wages and Rs 15 in material. The company sells both products on one period credit terms, but the company's labour and material expenses must be paid in cash. The selling price of C1 is Rs 30 per unit and of C2 it is Rs 70 per unit. Because of the company's strong monopoly in these components, it is assumed that the company can sell, at the prevailing prices, as many units as it produces. The company's production capacity is, however, limited by two considerations. First, at the beginning of period 1, the company has an initial balance of Rs 4,000 (cash plus bank credit plus collections from past credit sales). Second, the company has, in each period, 2,000 hours of machine time and 1,400 hours of assembly time. The production of each C1 requires 3 hours of machine time and 2 hours of assembly time, whereas the production of each C2 requires 2 hours of machine time and 3 hours of assembly time. Formulate this problem as an LP model so as to maximize the total profit to the company.

Solution:

The data of the problem is summarized as follows:

Resources/Constraints	*Components*		*Total Availability*
	C1	*C2*	
Budget (Rs)	10/unit	40/unit	Rs 4,000
Machine time	3 hrs/unit	2 hrs/unit	2,000 hours
Assembly time	2 hrs/unit	3 hrs/unit	1,400 hours
Selling price	Rs 30	Rs 70	
Cost (wages + material) price	Rs 10	Rs 40	

Decision variables: Let x_1 and x_2 = number of units of components C1 and C2 to be produced, respectively.

The LP model:

Maximize (total profit) Z = Selling price – Cost price

$= (30 - 10)\ x_1 + (70 - 40)\ x_2 = 20\ x_1 + 30\ x_2$

Subject to the constraints -

(i) The total budget available

$10\ x_1 + 40\ x_2 \leq 4{,}000$

(ii) Production time

(a) $3\ x_1 + 2\ x_2 \leq 2{,}000$; (b) $2\ x_1 + 3\ x_2 \leq 1{,}400$

and $x_1, x_2 \geq 0$.

Illustration 2

A pharmaceutical company produces two pharmaceutical products: A and B. Production of both these products requires the same process – I and II. The production of B also results in a by-product C at no extra cost. The product A can be sold at a profit of Rs 3 per unit and B at a profit of Rs 8 per unit. Some quantity of this by-product can be sold at a unit profit of Rs 2, the remainder has to be destroyed and the destruction cost is Re 1 per unit. Forecasts show that only up to 5 units of C can be sold. The company gets 3 units of C for each unit of B produced. The manufacturing times are 3 hours per unit for A on process I and II, respectively, and 4 hours and 5 hours per unit for B on process I and II, respectively. Because the product C is a by-product of B, no time is used in producing C. The available times are 18 and 21 hours of process I and II, respectively. Formulate this problem as an LP model to determine the quantity of A and B which should be produced, keeping C in mind, to make the highest total profit to the company.

Solution:

The data of the problem is summarized as follows:

Constraints/Resources	*Time (hrs) Required by*			*Availability*
	A	*B*	*C*	
Process I	3	4	–	18 hrs
Process II	3	5	–	21 hrs
By-product ratio from B	–	1	3	5 units (max.) Profit per unit (Rs)
	3	8	2	

Decision variables: Let

x_1 and x_2 = units of product A and B to be produced, respectively

x_2 and x_4

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DIRECT TAX LAWS AND INTERNATIONAL TAXATION (DTI)

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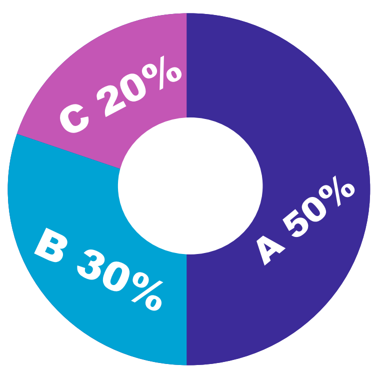
Your Preparation Quick Takes



Syllabus Structure

A Advanced Direct Tax Laws **50%**
B International Taxation **30%**
C Case StudyAnalysis **20%**

Learning Objectives:

- To develop basic idea about the problem of International double taxation
- To get acquainted with the methods of reliefs
- To have acquaintance with the basic provisions of the provisions of the Indian Income-tax Act regarding reliefs for double taxation.

Tax Planning, Tax Evasion and Tax Avoidance

Tax law reflects the complexity of modern life and the multitude of choices and options available to all taxpayers when legitimately seeking to structure their affairs. This necessary offer of options within tax legislation creates the opportunity for choice on the part of the tax payer and means that determining the right amount of tax (but no more) that they seek to pay does necessarily requires the exercise of judgement on occasion. So long as the exercise of that judgement seeks to ensure that the taxpayer makes choices that exercise options clearly allowed by law and that they do not exploit unintended loopholes created between laws then that process of a taxpayer choosing how to structure their affairs is the process of tax planning, which is a legitimate, proper and socially acceptable act.

Thus, tax planning is a systematic evaluation of finances and investments, to reduce the tax burden in a legitimate way. It involves understanding the tax implications of various cash inflows and outflows such as salary composition, property income, home loan, investments, sale or purchase of assets, gifts and interest-bearing deposits, to draw up an appropriate investment strategy that allows realization of financial goals while at the same time reducing tax liability to minimum.

It is a way to reduce tax liability by taking full advantages provided by the Act through various exemptions, deductions, rebates & relief. In other words, it is a way to reduce tax liability by applying script & moral of law. The two basic approaches of tax planning are:

1. ***Reducing taxable income***: As a rule, higher the income or profit, higher the tax liability on such income or profit. Gross income is total profits or income from all sources, and taxable income is such gross income less adjustments allowable under various tax laws and other provisions. Such adjustments bases itself on the nature of income and expenditure. Opting for the income or expenditure heads that allows maximum set-offs from the gross income reduces taxable income, and by extension tax liability.

2. ***Deferring payment of taxes to the extent possible***: An underestimated dimension of tax planning is timing investments and financial transactions so that the tax liability for such transactions arises at the farthest possible time. While this does not reduce the amount of tax payable, it delays tax outgo, thereby effectively providing interest-free cash on hand. Individuals may not need to resort to such a strategy, but delayed pay-out is valuable for small businesses that very often face cash flow difficulties.

The goal of tax planning is to arrange your financial affairs so as to minimize your taxes. It is the planning so as to attract minimum tax liability or postponement of tax liability for the subsequent period by availing various incentives, concessions, allowance, rebates and relief provided in the Act

Objectives of Tax Planning

Tax planning is an exercise undertaken to minimize tax liability through the best use of all available allowances, deductions, exclusions, exemptions, etc. The objectives of tax planning cannot be regarded as offending any concept of the taxation laws and subjected to reprehension of reducing the inflow of revenue to the Government's coffer, so long as the measures are in conformity with the statue laws and the judicial expositions thereof. The basic objectives of tax planning are:

a. ***Reduction of Tax liability***

Tax law provides multiple choices and options to taxpayers. This necessary offer of options within tax legislation creates the opportunity for choice on the part of the tax payer. However, due to lack of awareness of legal requirements, in many a cases, a taxpayer may suffer heavy taxation. Through proper tax planning and awareness, a tax payer may reduce such heavy tax burden.

b. ***Minimisation of litigation***

In the matter of taxation, the tax payers will try to pay the least tax and on the other hand, the tax administrator will attempt to extract the maximum. This conflict behaviour may results into litigations. However, where proper tax planning is adopted by the tax payer in conformity with the provisions of the taxation laws, the incidence of litigation can be minimised. This saves him from the hardships and inconveniences caused by the unnecessary litigations.

c. ***Productive investment***

A tax payer may reduce heavy tax burden through proper tax planning. Such reduction results into reduction in cash-outflow. In the days of credit squeeze and dear money conditions, even a rupee of tax decently saved may be taken as an interest-free loan from the Government, which perhaps, an assessee need not repay. Such retained cash can be utilised in other productive venture which also provide additional earning to the taxpayer. That means, proper tax planning is a measure of proper utilisation of available resources which in turn maximise the cash-inflow and minimise the tax burden.

d. *Healthy growth of economy*

The growth of a nation's economy is synonymous with the growth and prosperity of its citizens. In this context, a saving of earnings by legally sanctioned devices fosters the growth of both, because savings by dubious means lead to generation of black money, the evils of which are obvious. Conversely, tax-planning measures are aimed at generating white money having a free flow and generation without reservations for the overall progress of the nation. Tax planning assumes a great significance in this context.

e. *Economic stability*

Tax planning results in economic stability by way of:

(i) productive investments by the tax payers; and

(ii) harnessing of resources for national projects aimed at general prosperity of the national economy and reaping of benefits even by those not liable to pay tax on their incomes.

Essentials of Tax Planning

Following are the essentials of tax planning:

- Uptodate Knowledge of tax laws alongwith circulars, notifications, clarifications and Administrative instructions issued by the CBDT.
- Disclosure of full and true material information
- Avoid sham transactions or make-believe transactions or colourable devices
- Foresight of future development or changes and enterprise's goal.

Types of Tax Planning

The tax planning exercise ranges from devising a model for specific transaction as well as for systematic corporate planning. These are:

(a) Short-range and long-range tax planning: Short-range planning refers to planning to achieve some specific or limited objective of particular fiscal year. E.g., an individual assessee whose income is likely to register unusual growth in particular year as compared to the preceding year, may plan to subscribe to the PPF/NSC's within the prescribed limits in order to enjoy substantive tax relief. By investing in such a way, he is not making permanent commitment but is substantially saving in the tax. Long-range planning on the other hand, involves entering into activities, which may not pay-off immediately. E.g., when an assessee transfers his equity shares to his minor son he knows that the Income from the shares will be clubbed with his own income. But clubbing would also cease after his son attains majority.

***(b) Permissive tax planning*:** Permissive tax planning is tax planning under the express provisions of tax laws. Tax laws of our country offer many exemptions and incentives.

***(c) Purposive tax planning*:** Purposive tax planning is based on the basis of circumvention of the law. The permissive tax planning has the express sanction of the Statute while the purposive tax planning does not carry such sanction. E.g., If an assessee manages his affairs in such a way that his income is taxable in hands of other person without attracting clubbing provision, such a plan would work in favour of the tax payer because it would increase his disposable resources.

Ethical Way of reducing tax

Tax planning is an art of logically planning one's financial affairs, in such a manner that benefit of all eligible provisions of the taxation law can be availed effectively so as to reduce or defer tax liability. As tax planning follows an honest approach, by conforming to those provisions which fall within the framework of the taxation law. However, many time in the name of planning, assessee misleads the law, with / without making an offence. And to do so, the tax payer uses any scheme or arrangement, which reduces, defers and even completely prevents the payment of tax. This may also be done by shifting of tax liability to another person, so as to minimise the incidence of tax.

Tax evasion is the illegal way to reduce tax liability by deliberately suppressing income or sale or by increasing expenses, etc., which results in reduction of total income of the assessee. Dishonest taxpayers try to reduce their taxes by concealing income, inflation of expenses, submitting misleading information, falsification of accounts and willful violation of the provisions of the Income-tax Act. Such unethical practices often create problems for the tax evaders. Tax department not only imposes huge penalties but also initiate prosecution in such cases. It is illegal, both in script & moral. It is the cancer of modern society and work as a clog in the development of the nation. It is a grave problem in a developing country like ours as it leads to a creation of a 'resource crunch' for developmental activities of the State.

Tax avoidance is an exercise by which the assessee legally takes advantages, with malafide motive, of loopholes in the Act. Tax avoidance is minimizing the incidence of tax by adjusting the affairs in such a manner that although it is within the four corners of the laws, it is done with a purpose to defraud the revenue. It is a practice of dodging or bending the law without breaking it. It is a way to reduce tax liability by applying script of law only. E.g. if A gives gift to his wife, the income from the asset gifted will be clubbed in the hand of A. But to avoid this clubbing provision "A" decides to give gift to B's wife and B reciprocates it by giving gift to A's wife. This is not tax planning but tax avoidance. Most of the amendments are aimed to curb such loopholes.

The Direct Taxes Enquiry Committee (Wanchoo Committee) has tried to draw a distinction between the two items in the following words.

"The distinction between 'evasion' and 'avoidance', therefore, is largely dependent on the difference in methods of escape

resorted to. Some are instances of merely availing, strictly in accordance with law, the tax exemptions or tax privileges offered by the government. Others are maneuvers involving an element of deceit, misrepresentation of facts, falsification of accounting calculations or downright fraud. The first represents what is truly tax planning, the latter tax evasion. However, between these two extremes, there lies a vast domain for selecting a variety of methods which, though technically satisfying the requirements of law, in fact circumvent it with a view to eliminate or reduce tax burden. It is these methods which constitute "tax avoidance".

The Royal Commission on Taxation for Canada has explained the concept of tax avoidance as under:

"Tax Avoidance" will be used to describe every attempt by legal means to prevent or reduce tax liability which would otherwise be incurred, by taking advantage of some provisions or lack of provisions of law. It excludes fraud, concealment or other illegal measures.

Line of demarcation

The line of demarcation between tax avoidance and tax planning is very thin and blurred. There are two thoughts about tax avoidance –

a) As per first thought it is legal. Such thought is also supported by various judgments of the Supreme Court, some of them are as follows -

Helvering vs. Greggory **(1934)**

"Anyone may so arrange his affairs that his taxes shall be as low as possible. He is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes."

IRC vs. Duke of Westminster **(1936)**

"Taxpayer is entitled to so arrange his affairs that the tax under the appropriate Act is less than what otherwise it could be."

Inland Revenue Commissioners vs. Fishers Executors **(1958)**

"The highest in authority, have always recognized that the subject is entitled so to arrange his affairs as not to attract taxes imposed by the Crown, so far he can do so within the law, and that he may legitimately claim the advantage of any express terms or any omissions that he can find in his favour in taxing Act. In doing so, he neither comes under liability, nor incurs blame."

CIT vs. Raman & Co. **(1968)**

"Avoidance of tax liability by so arranging commercial affairs that the charge of tax is distributed, is not prohibited. A taxpayer may resort to a device to divert the income before it accrues or arises to him. Effectiveness of the device depends not upon considerations of morality, but on the operation of the Income-tax Act."

Smt. C. Kamala vs. CIT **(1978)**

"It is quite possible that when a transaction is entered into in one form known to law, the amount received under that transaction may attract liability under the Act and if it is entered into in another form which is equally lawful, it may not attract such tax liability. But when the assessee has adopted the latter one, it would not be open to the court to hold him liable for tax."

CWT vs. Arvind Narotham **(1988)**

"It is true that tax avoidance in an underdeveloped or developing economy should not be encouraged on practical as well as ideological grounds. One would wish….. that one could get the enthusiasm ….. that taxes are the price of civilization and one would like to pay that price to buy civilization. But the question which many ordinary taxpayers very often, in a country of shortages with ostentatious consumption and deprivation for the large masses, ask is, does he with taxes buy civilization or does he facilitate the waste and ostentation of the few. Unless ostentation and waste in Government spending are avoided or eschewed, no amount of moral sermons would change people's attitude to tax avoidance."

b) As per second thought it is not a legal way to reduce tax burden and it should be prohibited.

McDowell & Co. Ltd. vs Commercial Tax Officer **(1985)**

Supreme Court observed - "we think time has come for us to depart from Westminster principle….tax planning may be legitimate provided it is within the framework of law. Colourable devices cannot be part of tax planning and it is wrong to encourage or entertain the belief that it is honourable to avoid the payment of tax by resorting to dubious methods. It is the obligation of every citizen to pay the honestly without resorting to subterfuges."

CIT vs B.M. Kharwar **(1969)**

Supreme Court held – "the taxing authority is entitled and is indeed bound to determine the true legal relation resulting from a transaction. If the parties have chosen to conceal by a device the legal relation, it is open to the taxing authorities to unravel the device and to determine the true character of relationship. But the legal effect of a transaction cannot be displaced by probing into substance of the transaction."

Justice O. Chinnappa Reddy of Supreme Court has, while briefing the evil consequences of tax avoidance in *Mc.Dowell & Co. Ltd. -vs.- CTO*, observed that one such evil consequence is the ethics (or the lack of it) of transferring the burden of tax liability to the shoulders of the guideless, good citizens from those of artful dodgers. As regards the ethics of taxation, he observed:

"We now live in a welfare State whose financial needs, if backed by law, have to be respected and met. We must recognize that there is behind taxation laws as much moral sanction as behind any other welfare legislation and it is a pretence to say that avoidance of taxation is not unethical and that it stands on no less moral plane than honest payment of taxation".

A similar observation was made by Lord Chancellor *in Latilla vs. Inland Revenue Commissioner (1943) 011 ITR (E.C) 0078:*

"There is, of course no doubt that they are within their legal rights but that is no reason why their efforts, or those of the professional gentlemen who assist them in the matter, should be regarded as a commendable exercise of ingenuity or as a discharge of the duties of the good citizenship. On the contrary, one result of such methods, if they succeed, is of course to increase pro tanto the load of tax on the shoulder of the body of good citizens who do not desire or do not know how to adopt these maneuvers."

Distinguish between Tax Planning, Tax Evasion, Tax Avoidance and Tax Management

Difference between tax planning, tax avoidance, tax evasion & tax management

Points of distinction	Tax planning	Tax Avoidance	Tax Evasion	Tax Management
Definition	It is a way to reduce tax liability by taking full advantages provided by the Act through various exemptions, deductions, rebates & relief.	It is an exercise by which the assessee legally takes advantage of the loopholes in the Act.	It is the illegal way to reduce tax liability by deliberately suppressing income or sale or by increasing expenses, etc., which results in reduction of total income of the assessee.	It is a procedure to comply with the provisions of the law.
Feature	Tax planning is a practice to follow the provisions of law within the moral framework.	Tax avoidance is a practice of bending the law without breaking it.	Tax evasion is illegal, both in script & moral.	It is implementation or execution part of taxation department of an organisation.
Object	To reduce tax liability by applying script & moral of law.	To reduce the tax liability to the minimum by applying script of law only	To reduce tax liability by applying unfair means.	To comply with the provisions of laws.
Approach	It is futuristic and positive in nature. The planning is made today to avail benefits in future.	It is futuristic but short term in nature, as loophole of the law will be corrected in future by amendments of the law.	It is concerned with past and applied after the liability of tax has arisen. It is done with negative approach to avail benefits by killing the moral of law.	It is a continuous approach, which is concerned with past (rectification, revisions etc.), present (filing of return, etc.) & future (corrective action).
Benefit	Generally, arises in long run.	Generally, arises in short run.	Generally, benefits do not arise but it causes penalty and prosecution.	Penalty, interest & prosecution can be avoided.
Treatment of Law	It uses benefits of the law.	It uses loopholes in the law.	It overrules the law.	It implements the law.
Practice	It is tax saving.	It is tax hedging.	It is tax concealment.	It is tax administration.
Need	It is desirable	It is avoidable	It is objectionable	It is essential.
Morality	It is moral in nature.	It is immoral in nature	It is illegal.	It is duty.

GROUP: iv, PAPER: 17

CORPORATE FINANCIAL REPORTING (CFR)

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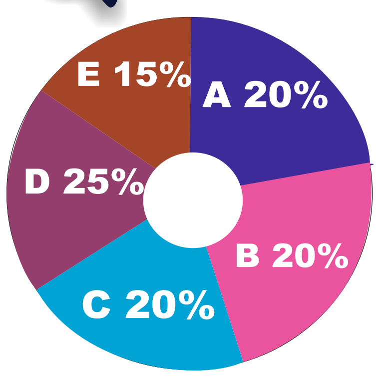
Your Preparation Quick Takes



Syllabus Structure

A GAAP and Accounting Standards **20%**
B Accounting if Business Comminations & Restructuring **20%**
C Consolidated Financial Statements **20%**
D Developments in Financial Reporting **25%**
E Government Accounting in India **15%**

Learning Objectives:

After studying the present section of Corporate Financial Reporting you will be able to:

- Learn how to highlight the achievements of a company to its investors, creditors, bankers, public, employees, regulatory bodies and Government on a periodic basis
- To convey future based strategic roadmap for the company.

Corporate Financial Reporting

Absorption, Amalgamation and External Reconstruction

In text books we find chapters on Absorption, Amalgamation and External Reconstruction based on AS 14. In all the cases the vendor company ceases to exist. If one company obtains control of another company while the acquiree company continues to exist, AS 14 is not applicable. Only investment in shares of the subsidiary company is recognised as asset of the acquirer company. So, for the companies complying with AS, AS 14 is applicable as above.

But for the companies complying with Ind AS, for the events like Absorption, Amalgamation and External Reconstruction Ind AS 103 and Ind AS 103 Appendix C are applicable. Two new terms are used: Business Combination (Ind AS 103) and Business Combination Under Common Control (Ind AS 103 Appendix C).

The change is that Ind AS 103 includes accounting of Absorption, Amalgamation and External Reconstruction and in addition it requires accounting in a consolidated set of accounts in the books of the acquirer for obtaining control of one or more businesses, when the acquiree continues to exist as a subsidiary.

For Absorption, Amalgamation and External Reconstruction, no consolidated set of accounts is required even for companies complying with Ind AS. The Purchasing company will account for the transactions following Ind AS103 and Ind AS 103 Appendix C for preparing individual financial statements.

Only when the acquiree company continues to exist after its control being obtained by the acquirer, the acquirer needs to maintain two sets of accounts, one for preparation of its individual financial statements and the other for preparation of consolidated financial statements.

Now let us see how the events like Absorption, Amalgamation and External Reconstruction are treated under Ind AS 103 with the help of illustrations.

Illustration 1 (Absorption). On March 31, 201X, A Ltd absorbed B Ltd. A Ltd. issued 60,000 equity shares (Rs.10 par value) that were trading at Rs. 25 on March 31. The book value of B's net assets was Rs.12,00,000, Equity Share Capital Rs. 5,00,000 and Other Equity Rs.7,00,000 on March 31. The fair value of net assets of B Ltd. was assessed at Rs.13,00,000.
Show journal entries complying Ind AS.

Solution:
It is a business combination under Ind AS 103. Accounting in the books of A Ltd. is done under acquisition method. Net assets and consideration are recognized at fair value, and their difference is recognized as Goodwill/ Gain on Bargain Purchase.

Workings:
Consideration = 60,000× Rs.25 = Rs.15,00,000
Goodwill = Rs.15,00,000 – Rs.13,00,000 = Rs.2,00,000

Journal Entries in books of A Ltd.:

Net Assets A/c	Dr.	Rs.13,00,000	
Goodwill A/c	Dr.	Rs.2,00,000	
To, Consideration A/c			Rs.15,00,000
Consideration A/c	Dr.	Rs.15,00,000	
To, Equity Share Capital A/c			Rs. 6,00,000
To, Security Premium A/c			Rs. 9,00,000

Illustration 2 (Amalgamation). On March 31, 201X, A Ltd and B Ltd. were amalgamated into C Ltd., control of the businesses lying with the same parties as before. C Ltd. issued 80,000 equity shares to A Ltd. and 75,000 equity shares to B Ltd. at the nominal value of Rs. 10 per share. The book value of A Ltd.'s net assets was Rs.12,00,000, Equity Share Capital Rs.5,00,000 and Other Equity Rs.7,00,000 on March 31. The fair value of net assets of A Ltd. was assessed at Rs.16,00,000. The book value of B Ltd.'s net assets was Rs.10,00,000, Equity share capital Rs.4,00,000 and Other Equity Rs.6,00,000 on March 31. The fair value of net assets of B Ltd. was assessed at Rs.15,00,000.
Show journal entries complying Ind AS.
Solution:
It is a transaction of Business Combination Under Common Control under Ind AS 103 Appendix C, where control lies with the same

parties before and after the transaction.
Pooling of Interest method will be applied. Consideration is measured only at nominal value of shares. Difference of consideration and other equity carried, with net assets be recognized as Goodwill or Capital Reserve. Net assets and Other Equity of the transferee company will be carried at book value.

Workings:
Consideration to A Ltd. = 80,000× Rs.10 = Rs.8,00,000
Consideration to B Ltd. = 75,000× Rs.10 = Rs.7,50,000
Total Consideration = Rs.15,50,000
Other Equity of A Ltd. and B Ltd. = Rs.7,00,000+ Rs.6,00,000 = Rs.13,00,000
Total Net assets = Rs.12,00,000 + Rs.10,00,000 = Rs.22,00,000
Goodwill = Rs.15,50,000 + Rs.13,00,000 – Rs.22,00,000 = Rs.6,50,000

Journal Entries in books of C Ltd.:
Net assets of A Ltd. A/c Dr. Rs.12,00,000
Net assets of B Ltd. A/c Dr. Rs.10,00,000
Goodwill A/c Dr. Rs. 6,50,000
To, Consideration A/c Rs.(8,00,000+7,50,000) Rs. 15,50,000
To, Other Equity A/c Rs.(7,00,000+6,00,000) Rs. 13,00,000

Consideration A/c Dr. Rs. 15,50,000
To, Equity Share Capital A/c Rs.15,50,000

Illustration 3 (External Reconstruction). On March 31, 201X, A Ltd externally reconstructed into B Ltd. B Ltd. issued 80,000 equity shares at the nominal value of Rs. 10 per share. The book value of A Ltd.'s net assets was Rs.12,00,000 on March 31. The fair value of net assets was assessed at Rs.15,00,000.
Show journal entries complying Ind AS.

Solution:
It is a transaction of Business Combination Under Common Control under Ind AS 103 Appendix C, where control lies with the same parties before and after the transaction.
Pooling of Interest method will be applied. Consideration is measured only at nominal value of shares, Difference of consideration and carried amount of Other Equity with the net assets will be recognized as Goodwill or Capital Reserve. Net assets and Other Equity of the transferee company will be carried at book value.
Workings:
Consideration = 80,000× Rs.10 = Rs.8,00,000
Goodwill = Rs.(8,00,000+6,00,000-12,00,000)= Rs.2,00,000

Journal Entries in books of B Ltd.:

Net assets A/c Dr. Rs.12,00,000
Goodwill A/c Dr. Rs. 2,00,000
To, Consideration A/c Rs. 8,00,000
To, Other Equity A/c Rs. 6,00,000

Consideration A/c Dr. Rs. 8,00,000
To, Equity Share Capital A/c Rs.8,00,000

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YEARS OF CELEBRATING THE MAHATMA

GROUP: iv, PAPER: 18

INDIRECT TAX LAWS & PRACTICE (ITP)

CMA Rana Ghosh
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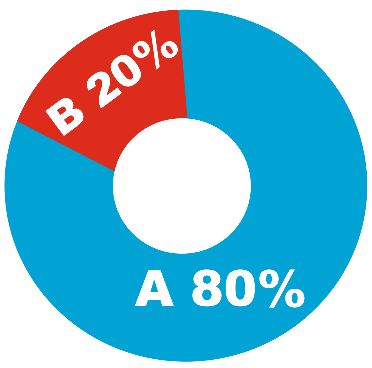
Your Preparation Quick Takes



Syllabus Structure

A Advanced Indirect Tax and Practice **80%**

B Tax Practice and Procedures **20%**

Learning Objectives –

Through the following MCQ, students can refresh themselves about

- Allow of ITC
- Input Supply and Input Tax
- Supply to job worker
- Deemed supply
- Input Service Distributer
- Aggregate turnover and registration
- Distinct person
- Goods and Service Tax Identification Number (GSTIN)

INDIRECT TAX

Choose the correct option from the followings –

1. In which of the following case ITC will be allowed

(a) Cement is used for construction of administration building
(b) Steel and other structural supports are used for Land, building
(c) GST paid on parts of telecommunication towers or parts of pipelines
(d) Cement is used for foundation of pillars supporting a boiler

2. In which of the input supplies need not requited to be reversed on subsequent occurrence of the below-mentioned event

(a) Recipient of supply Doesn't pay to the supplier within 180 days of issue of the invoice.
(b) Recipient of supply uses input goods/services for supplying exempted supplies
(c) A person transfer his regular GST registration into Composite Scheme
(d) A person sells Plant and machinery

3. The amount of input tax in respect of capital goods intended to be used exclusively for non- business purposes shall be indicated in

(a) FORM GSTR- 1
(b) FORM GSTR- 2
(c) FORM GSTR- 3
(d) FORM GSTR- 4

4. Which one of the statement is not correct in relation to Job Worker?

(a) The ownership of the goods transfer to the job worker by the principal
(b) The ownership of the goods does not transfer to the job-worker by the principal
(c) The job worker is required to carry out the process specified by the principal on the goods.
(d) Job-works means, any treatment or process undertaken by a person on goods belonging to another registered person.

5. The supply to job worker will be considered Deemed Supply if the input after processing not being returned back within

(a) Six month
(b) Nine months
(c) One year
(d) Two year

6. As per Section 143 (5) of the CGST Act, 2017, waste generated at the premises of the registered job-worker which of the following statement is correct

(a) may be supplied directly by the registered job-worker from his place of business on payment of tax
(b) may be supplied directly by the registered job-worker from his place of business without payment of tax
(c) the principal may clear such waste without payment of tax
(d) the principal may clear such waste on payment of tax

7. For Input Service Distributor the expression "recipient of credit" means the supplier of goods or services or both having

(a) same place of business
(b) same Registration Number
(c) same Registered Office
(d) same Permanent Account Number

8. As per section 38 of the CGST Act, 2017 who can verify and validate, modify or delete the details relating to inward supply and credit or debit notes communicated to him

(a) Every registered person
(b) Input Service Distributer
(c) Non Resident taxable person
(d) Composition levy assesse

9. In relation to exception of One Registration for One State which of the following statement is correct

(a) Multiple registrations permitted for same business vertical
(b) Non resident Indian having business place in India
(c) Person paying tax under composition levy
(d) One as an input service distributor and other for outward supply

10. Job workers are eligible for exemption from GST registration where such job workers engaged in making inter-State supply of services to a registered person

(a) In relation to fabrication works
(b) In relation to polishing of machine parts
(c) In relation to silversmiths
(d) In relation to construction jobs in SEZ

11. As per Sec. 2(6) of CGST Act Aggregate turnover in a Financial Year which one of the following will be excluded

(a) The value of exported goods/services
(b) Inter-State supplies between distinct persons having same PAN
(c) Compensation Cess
(d) Supply on own account and on behalf of principal

12. Which of the following person will be excluded from compulsory registration

(a) Causal taxable persons making taxable supply
(b) Any person engaged exclusively in the business of supplying of goods or services or both
(c) Non-resident taxable person making taxable supply
(d) Input Service Distributor, whether or not separately registered under CGST

13. Which of the following a casual taxable person, before applying for registration will, declare

(a) Residential address
(b) Location of place of business
(c) E mail address
(d) Nature of business

14. FORM GSTR- 3 to be filled by casual taxable person

(a) on or before the tenth day of the following month
(b) after fifteenth day but before the twentieth day of the following month
(c) after tenth but before the fifteenth day of the following month
(d) after twelfth but before the fifteenth day of the following month

15. Which of the below mentioned statement is correct in relation to a non resident taxable person

(a) A non-resident taxable person can exercise the option to pay tax under composition levy.
(b) Input tax credit shall be available in respect of goods or services or both received
(c) Input tax credit shall be available in respect of goods imported by him
(d) Has fixed place of business or residence in India

16. Clearing and forwarding (C&F) Agent receives goods on behalf of the principal, subsequently he supplies goods to the customer as an agent of the principal. He maintains the stock and report to the principal. If so such an agent

(a) shall be liable to obtain the registration compulsorily irrespective of the aggregate turnover
(b) shall be liable to obtain the registration if the aggregate turnover increase more than ten lakhs
(c) Not required to obtain registration till the aggregate turnover crosses threshold limits
(d) Registration depends on the nature of supply

17. An ISD will have to file monthly returns in GSTR-6 after the end of the month and will have to furnish information of all ISD invoices issued

(a) within 10 days
(b) within 13 days
(c) within 15 days
(d) within 20 days

18. Which one of the following is not correct in relation to 'Distinct persons are persons'

(a) with different GSTINs belonging to one legal entity (single PAN) situated within the same state
(b) with different GSTINs belonging to one legal entity (single PAN) situated in two different states
(c) with different GSTINs belonging to one legal entity (single PAN) situated in a different country
(d) with same GSTIN belonging to one legal entity (single PAN) situated in two different states or country

19. Which one of the following is incorrect in connection with Goods and Service Tax Identification Number (GSTIN)

(a) Two characters for the State code
(b) Ten characters for the PAN
(c) Two characters for the entity code
(d) Two checksum characters

20. Which of the following reason is correct for cancellation of GST registration number

(a) A composition registered person has not filed tax returns for two consecutive quarters
(b) A voluntarily registered person who has not commenced any business in the four months from the registration date
(c) There is any change in the constitution of the business
(d) A normal registered person who has not filed returns consecutively for one year

ANSWERS

1	d	6	a	11	c	16	a
2	b	7	d	12	b	17	b
3	b	8	a	13	c	18	d
4	a	9	d	14	b	19	d
5	c	10	c	15	c	20	c

YEARS OF CELEBRATING THE MAHATMA

CMA S S Sonthalia
Practicing Cost Accountant
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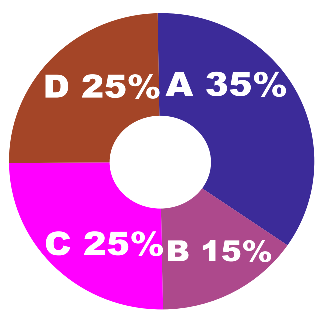
sonthalia_ss@yahoo.co.in

GROUP: iv, PAPER: 19

COST & MANAGEMENT AUDIT (CMAD)

Your Preparation Quick Takes



Syllabus Structure

A Cost Audit **35%**
B Management Audit **15%**
C Internal Audit, Operational Audit and other related issues **25%**
D Case Study on Performance Analysis **25%**

Learning Objectives:

- To verify the correctness of the cost accounting records.
- To find out whether the principles of cost accountancy have been fully and correctly applied in maintaining cost records.
- To search for the deficiencies in the cost record system of the company.
- To attain efficiency in cost accounting systems and procedures

Cost & Management Audit

Problem on Reconciliation

Question

Sunshine Textiles Ltd engaged in manufacturing of readymade garments. Since last two year company is maintaining cost records in compliance with sub-section (1) of Sec-148 of The Companies Act, 2013. The details of profit & Loss statement is given below:

Statement of Profit & Loss for the year ended 31st March 2021

(Rs.in Crore)

Si. No.	Particulars	For the Year ended 31 Mar 2021
1.	Income	
	a. Revenue from Operation	327.36
	b. Other income	23.39
	Total Income	**350.75**
2.	Expenses	
	a. Cost of Material Consumed	194.26
	b. Change in inventories of finished goods	6.8
	c. Employee Benefit Expenses	41.85
	d. Finance cost	18.08
	e. Depreciation & Amortisation	14.96
	f. Other expenses	32.02
	Total Expenses	**307.97**
3.	**Profit /(Loss) before exceptional item & Tax**	**42.78**
4.	Exceptional Items	00
5.	**Profit before Tax after Exceptional items**	**42.78**

The Financial result of the company for the year ended March 31, 2021 has arrived at Profit of Rs. 42.78 Crore whereas profit as per Cost Accounting Records Rs. 53.84 Crore. The Profit and loss account has been prepared based on following items:

Si. No.	Particulars	Rs.in Crore
1.	**Cost of materials includes :-**	
I	Demurrage charge on Raw material	2.65
ii.	Cost of Material includes prior period adjustment	12.54
iii.	Packing Material Cost	18.50

2.	**Other income in includes:-**	
I	Provision Written Back	0.80
ii.	Liquidated Damage received	1.85
iii.	Interest on Security deposit with Electricity Company	0.54
iv.	Sale of Scrap	6.35
v.	Interest on Income Tax Refund	0.45
v.	Interest Income from Advance to Supplier	0.78
3.	**Employee Cost in includes**	
I	Apprenticeship Training Stipend	0.58
ii.	Arrear salary relating to prior period	4.23
iii.	Wages paid to Temporary labour	7.28
iv.	Free housing and free conveyance	3.72
v.	Recruitment cost	0.86
vi.	Special incentive for Covid -19	2.45
4.	**Other expenses includes:**	
I	Expenses for Covid-19 Vaccination camp	0.66
ii.	Loss on Sale of Machinery	0.27
5.	Change in inventory of Closing WIP and Finished goods :-	
	as per Financial Accounts	6.80
	as per Cost Accounts	10.42

Additional Note:-
1. Sale of scrap includes Rs. 2.65 Crore which relates to sale of waste sack and boxes used in packing of finished goods and the rest of scrap are generated due to the cyclone.
2. 20% of packing cost is incurred for a special type of packaging for transport convenience.
3. Special incentive for Covid-19 is paid temporarily for 4 months.

Prepare a Reconciliation Statement in accordance with Part-D (para-2) of Annexures to Cost Audit Report for the year ended March 31, 2021.

Answer:

Reconciliation of Profit between Cost and Financial Accounts for the year ended March 31, 2021

Particulars	Amount (Rs. In Crore)	Amount (Rs. In Crore)
Profit /(Loss) as per Cost Accounts		**53.84**
Add: Incomes not considered in Cost accounts:		
Provisions Written Back		

Liquidated Damages received		
Interest on Security deposit with Electricity Company		
Sale of Scrap (Non-operational)		
Interest on Income Tax Refund		
Interest Income from Advance to Supplier		**8.12**
Sub-total		**62.68**
Less: Expenses not considered in Cost accounts:		
Demurrage charge on Raw materials		
Cost of Material includes Prior period adjustments		
Arrear salary relating to Prior period	4.23	
Loss on Sale of Machinery		
Special incentive for Covid -19	2.45	
Expenses for Covid-19 Vaccination camp	0.66	
		22.80
Sub-total		**39.16**
Add/(less):Overvaluation / (Undervaluation) of Closing Stock and Opening Stock		3.62
Profit/ (Loss) as per Finance Accounts		**42.78**

Note:

1. As per CAS-7:

i. Employee cost includes benefits paid to temporary, part time & contract employees.

ii. Employee cost includes benefit paid to employee such as free housing, free conveyance etc.

iii. Overtime premium, recruitment cost & training cost are part of employee cost.

2. Cost incurred for Special packing is part of secondary packing and treated as Selling And distribution Cost.

3. Special incentive for Covid-19 is incurred for an abnormal situation for which it treated as Non-cost.

4. As per Circular no. 01/2021 dated 13.01.2021 of Ministry of Corporate Affairs, spending on Covid-19 Vaccination programme is eligible as CSR activity.

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University of Calcutta
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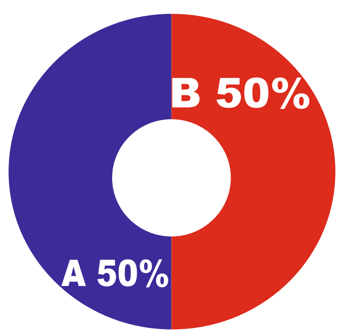
GROUP: iv, PAPER: 20

STRATEGIC PERFORMANCE MANAGEMENT AND BUSINESS VALUATION (SPBV)

Your Preparation Quick Takes



Syllabus Structure

A Strategic Performance Management **50%**
B Business Valuation **50%**

Learning objectives:

After studying this section on Strategic Performance Management and Business Valuation, you will be able to:

- understand H Model and Three Stage Growth Model of equity share
- solve the problems on H Model and Three Stage Growth Model of equity share

Strategic Performance Management and Business Valuation

Choose the correct option from amongst the four alternatives given:
(Each question carries 1 mark)

1. **Which one of the following is NOT true about On-Line Analytical Processing (OLAP)?**
   (a) OLAP functionality includes trend analysis over sequential time periods.
   (b) It provides slicing subsets for on-screen viewing.
   (c) It is a category of hardware technology.
   (d) It helps the end user to drill-down to deeper levels of consolidation data.

2. **A Company based on up-to-date financial statements has determined that the current Free Cash Flows to Equity (FCFE) per share is Rs.1.00. It has outstanding number of shares 100 Crore with a face value of Rs.10 each. Its interest expenses are Rs. 30 Crore and Tax rate is 30%. Given this information, The Free Cash Flow to the Firm (FCFF) will be-**
   (a) Rs. 109 Crore
   (b) Rs. 112 Crore
   © Rs. 118 Crore
   (d) Rs. 121 Crore

3. **Which one of the following is not a measure related to Balanced Score Card?**
   (a) Gap Analysis
   (b) Financial
   (c) Internal Processes
   (d) Customer Satisfaction

4. **The price elasticity of demand for a product is infinity. If the firm increases price of the product by 10%, total revenue of the firm will -**
   (a) Increase to infinity
   (b) Fall to zero
   (c) Decrease by more than 10%
   (d) Decrease by less than 10%.

5. **Which of the following is not an actuarial concept used in risk pooling?**
   (a) Statistical variation
   (b) The law of averages
   (c) The law of large numbers
   (d) The law of subjective judgment

Answers:

Question No	(1)	(2)	(3)	(4)	(5)
Answer	(c)	(d)	(a)	(b)	(d)

Section B
Each question carries 1 mark.

1.	If the average cost function of a firm is given by $AC = x^2 - 4x + 7$, in terms of output x, what will be its marginal cost?
Answer	Total cost (c) = $x(x^2 - 4x + 7) = x^3 - 4x^2 + 7x$ Marginal cost = $d/dx\,(x^3 - 4x^2 + 7x) = 3x^2 - 8x + 7$

2.	The value of Alpha Ltd. and Beta Ltd. are Rs.50 lakh and Rs.25 lakh respectively. On merger their combined value Rs.94 lakh. If Beta Ltd. receives premium on merger Rs.15 lakh, what will be the synergy gain for merger?
Answer	Synergy gain for Merger: Combined Value-Value of Merging Companies = Rs. [(94) - (50 + 25)] = Rs.19 lakh (Premium on merger is irrelevant)
3.	Given: The risk-free rate is 5.5%; the market price of risk=7% and the company's Beta=1.2. Calculate the Cost of Equity.
Answer	Cost of Equity=5.5% + 7% (1.2) =13.9%
4.	What is Quality Circle?
Answer	Quality Circle is a small group of 6 to 12 employees doing similar work who voluntarily meet together on a regular basis to identify improvements in their respective work areas using proven techniques for analysing and solving work related problems coming in the way of achieving and sustaining excellence leading to mutual up liftmen of employees as well as the organisation. It is a way of capturing the creative and innovative power that lies within the work force.
5.	If a company has a P/E ratio of 20 and a ROE (Return on Equity) of 0.20%, then calculate the Market to Book Value Ratio.
Answer	Since, P/E x ROE = 20 x 0.20= 4 Times

Section C

Problem 1

A company has a capital base of Rs. 3 crore and has earned profits of Rs. 33 Lakhs. Return on investment of the particular industry to which the company belongs is 12.5%. If the services of a particular executive are acquired by the company, it is expected that the profits will increase by Rs. 7.5 lakhs over and above the target profit.

Particulars	Rs.
Capital Base	3,00,00,000
Actual profit	33,00,000
Target profit (` 3Cr ×12.5%)	37,50,000

Based on the above information, answer the following questions:

(a) Determine the maximum salary payable to the particular executive. 4 Marks

Answer:

Maximum Salary Payable:

Particulars	Rs. Lakhs
Capital Base	300.00
Target Profits(= Capital Base x 12.50%)	37.50
Add: Extra Profits due to induction of the Executive	7.50
Total Profits of the Company (anticipated after induction of the Executive)	45.00
Less: Current Profits	33.00
Incremental Profit	12.00

Maximum Salary = Incremental Profit due to introduction = Rs.12.00 Lakhs per annum.

(a) Determine the amount of maximum bid price for that particular executive. 2 Marks

Answer:

= Value of Salary Payable in perpetuity = Maximum Salary Payable ÷ Desired Rate of Return on Investment = Rs. 12 Lakh ÷ 12.5% = Rs. 96 Lakhs.

Problem 2

The following information is provided in relation to the acquiring firm P Ltd. and the target firm Q Ltd.

Particulars	P Ltd.	Q Ltd
Earnings after tax (Rs.)	300 lakhs	60 lakhs
Number of shares outstanding	20 lakhs	10 lakhs
P /E Ratio	10	5

Based on the above information answer the following questions:

Working Note:

Particulars	P Ltd.	Q Ltd.
Earnings after tax (Rs.)	300 lakhs	60 lakhs
Number of shares outstanding	20 lakhs	10 lakhs
P /E Ratio	10	5
EPS (Rs.)	15	6
Market price (Rs.)	150	30

(a) What is the swap ratio in terms of current market price? 2 Marks

Answer:
Swap ratio in terms of market prices: 30/150 = 0.20

(b) What is the EPS of P Ltd. after acquisition? 2 Marks

Answer:
EPS of P Ltd. after acquisition: (300 + 60) / (20 + 0.2×10) = 360/22 or say Rs.16.36

(c) What is the expected market price per share of P Ltd. after acquisition assuming that P / E ratio of P Ltd. remains unchanged? 2 Marks

Answer:
Expected market price per share of P Ltd. with the same P/E ratio of 10 will be: 16.36 × 10 = Rs.163.6

(d) Determine the market value of the merged firm. 2 Marks

Answer:
Market value of merged firm: Total number of outstanding shares × market price = Rs. 3599.2 lakhs.

PRACTICAL Advice

ABOUT YOUR STUDIES - FINAL COURSE

Practical support, information and advice to help you get the most out of your studies.

START

01 Read Study Notes, MTPs,E-Bulletin, Work Books, Attend Webinar sessions

02 Solve Excercises given in Study Note

03 Assess Yourself

04 Appear For Examination

FINISHED

SUBMISSIONS

Dear Students,

We are very much delighted to receive responses from all of you; for whom our effort is!

We have noted your queries and your requests will definitely be carried out. Further, requesting you to go through the current edition of the bulletin. All the areas will be covered gradually. Expecting your responses further to serve you better as we believe that there is no end of excellence! One of the mails received is acknowledged below.

Please put your opinions so that we can make your e-bulletin everything that you want it to be.

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Passing the exam is a happy event. Congratulations on all that you have accomplished! There is no secret of success. It is the result of preparation, hard work and learning from failure. Well done! It is clear that the future holds great opportunities for you.

Those who could not pass, failing in an exam does not mean failing in life. All of us face failure at one time or another. Try to focus your attention on the importance of perseverance and mind it that dedication and determination plays the lead role in shaping a person's life.

We from the Directorate of studies know your expectations from us and accordingly we are trying to deliver some meaningful tips through the publications of monthly E-bulletins. Other than this we are trying to help you through, Mock Test Papers (MTPs), Work Books, MCQs and we have conducted Webinar sessions.

You know that the nation is celebrating 150th birth anniversary of the father of the nation M.K. Gandhi. One of his inspirational message towards the students were:

"You must be the Change you wish to see in the World",

Let us observe his memory by following his message.

Certain general guidelines are listed below and which will help you in preparing yourselves:

- Conceptual understanding & Overall understanding of the subject should be clear.
- Candidates are advised to go through the study material provided by the Institute in an analytical manner.
- Students should improve basic understanding of the subject with focus on core concepts.
- The Candidates are expected to give to the point answer, which is a basic pre-requisite for any professional examination.
- To strengthen the answers candidates are advised to give answer precisely and in a structured manner.
- In-depth knowledge about specific terms is required.
- Write question numbers correctly and prominently.
- Proper time management is also important while answering.

Please refer the link mentioned below :

https://icmai.in/studentswebsite

- Don't give up
- Don't give in
- Don't give out

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Few Snapshots

Glimpses of the Child Literacy Program organised by the Institute to commemorate Azadi Ka Amrit Mahotsav on 24.09.2021 at CMA Bhawan, New Delhi.

Glimpses of Swachhta Abhiyan program organised by the Institute to commemorate Azadi Ka Amrit Mahotsav on 01.10.2021 at CMA Bhawan, New Delhi.

CMA P. Raju Iyer, Vice-President along with CMA Neeraj Joshi, Council Member of the Institute and CMA B.B. Goyal, Former Addl. Chief Adviser (Cost), Ministry of Finance, GoI, extending greetings to Shri Arun Goel, IAS, Secretary to the Government of India, Ministry for Heavy Industries during a meeting on 1st October, 2021 to submit a detailed representation relating to Cost Audit in the notified PLI Scheme for Automotives and Auto Components.

CMA (Dr.) Ashish P. Thatte, Chairman, Corporate Laws Committee along with CMA Neeraj D. Joshi, Chairman, Management Accounting Committee extending greetings to Shri Narayan Tatu Rane, Hon'ble Union Minister for Micro, Small and Medium Enterprises on 2nd August, 2021

CMA P. Raju Iyer, Vice President along with CMA Chittaranjan Chattopadhyay, Chairman BFSI Board & Indirect Taxation Committee of the Institute and CMA B.B. Goyal, Advisor, ICWAI MARF & Former Addl. Chief Adviser (Cost), Ministry of Finance, GoI extending greetings to CMA (Dr.) Manoj Anand, Whole Time Member (Finance), Pension Fund Regulatory and Development Authority (PFRDA) on 25.08.2021.

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