2022
January
VOL: 7, NO.: 1,

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150 YEARS OF CELEBRATING THE MAHATMA

CMA Student E - Bulletin

FINAL

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www.icmai.in
Headquarters: CMA Bhawan, 12 Sudder Street, Kolkata - 700016
Ph: 091-33-2252 1031/34/35/1602/1492
Delhi Office: CMA Bhawan, 3 Institutional Area, Lodhi Road, New Delhi - 110003
Ph: 091-11-24666100

Behind every successful business decision, there is always a CMA

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150 YEARS OF CELEBRATING THE MAHATMA

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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.

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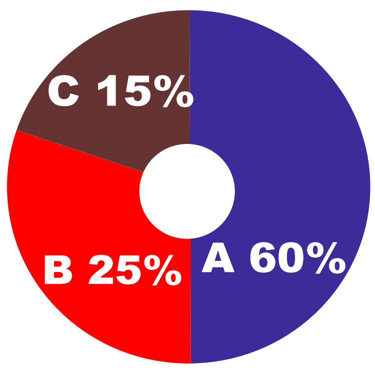
YEARS OF CELEBRATING THE MAHATMA

GROUP: iii, PAPER: 13

CORPORATE LAWS & COMPLIANCE (CLC)

Shri Subrata Kr. Roy
Company Secretary & Consultant
He can be reached at:
subrataoffice@rediffmail.com

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.

Evaluation and Implementation of CSR projects in a company

This chapter would make you ready to take up the CSR projects by a company for the first time. Steps and checklist are as follows.

(a) Constitution of CSR Committee (discussed in previous chapter)
(b) CSR Policy
(c) Budget
(d) Infrastructure: make a team , an office, etc.

(d) thrust area:
an area has to be selected out of a broad list so that the domain experience by the company which will help in better service.
thrust area is not a pre requisite and company can spend money in diverse areas but this will narrow down the targets.
(e) Identification of project: website search, visit few NGOs, Govt. facilitating agencies
(f) Evaluation
(g) Implementation
(h) Monitoring
(i) Impact Assessment
(j) Review of the Policy

CSR Policy

This policy shall be made and recommended by the CSR committee to the Board who will approve the same.

The policy shall:

(a) be appropriate to the nature and scale of the company's activities, products and services.

(b) define a specific organization structure for guidance, implementation, monitoring and review of the projects/activities and targets for CSR.

(c) be documented, implemented, maintained, and communicated to all persons working for the organisation, and on behalf of it.

(d) Approved by Board, known to all stakeholders

(e) Constitution of CSR committee, as per the companies Act.

(f) CSR activities to be taken up by the company shall be within the scope of schedule VII of the Act.

(g) Shall have a list of CSR projects or programs which a company plans to undertake with modalities of execution and implementation schedule

(h) Monitoring process of such projects.

(i) Shall specify that surplus arising out of the CSR projects shall not form business profit of the company.

Budget (in compliance of the Act)

The following needs to be complied with.

(a) Minimum 2 % of the average net profit of last 3 years shall have to be spent.
(b) Overheads like travelling, salaries, lodging etc. shall be included.
(c) Expenditure shall preferably made in project mode.
(d) Third party engagement cost for implementing shall be taken.

What is not CSR

(a) Publicity activities with only intention to advertise product/services.
(b) Compliance of regulation, Govt. order.
(c) Employee benefits, employees' family benefit, direct or indirect.
(d) Anything done in physical environment to facilitate production, distribution of goods.
(e) Contribution to political parties or for political purpose.

Evaluation of the project

The projects are to be evaluated on following parameters

1. The beneficiaries
2. Need
3. Chances of implementation
4. Background of the implementing agencies
5. Technical feasibility
6. Other documentation

Collaborative projects

When companies decide to do something for the society under CSR, it may not be possible to do with standalone infrastructure unless the company is very big. Therefore, they need to collaborate, partner or supplement with external agencies which can be a GOVT. agency, academic institution or na NGO.

(a) With other companies:
(b) With Govt. under PPP model.
(c) With specialized agencies.

Specialized implementing Agencies

1. Community based organizations whether formal or informal;
2. Elected local bodies such as Panchayats;
3. Voluntary Agencies (NGOs);
4. Institutes/Academic Organisations;
5. Trusts, Missions, etc.(NGOs)
6. Self-help Groups;
7. Government, Semi-Government and autonomous Organisations;
8. Mahila Mandals/Samitis and the like;

Direct implementation by the company

Advantages

(a) Flexible
(b) Better supervision
(c) Quick decision making
(d) Less coordination
(e) Less cost

Disadvantages

(a) Manpower involvement
(b) Lack of domain knowledge
(c) No 80 G benefit
(d) Biased
(e) Corrective action not clearly defined
(f) Negative points remains undocumented.
(g) Lack of local area knowledge and language
(h) Lack of adequate monitoring due to other issues

Third party implementation: advantages

(f) expertise
(g) Better supervision at site
(h) unbiased
(i) Single point coordination
(j) Negotiate cost

Disadvantages

(i) May be more supervision
(j) Lack of domain knowledge of the agency

(k) No 80 G benefit
(l) Biased, if also beneficiary
(m)No proper accounting
(n) Negative points remains undocumented.
(o) Dominance in local area
(p) Lack of adequate monitoring by the company

Problems in implementation
Internal

(a)deciding preferences of projects:
(b) Financial Mismatch
(c) Lack of seriousness by management.
(d) Right people to work.
(e) Internal references
(f) Indecisiveness / difference in opinion of the team/ committee

External

(a)Political pressure.
(b) Social pressure.
©Projects' road block due to uncontrollable reasons.
(d)Inefficient implementing agency.
(e)Diverting money
(f) Siphoning money
(g) Fraud

Due Diligence of CSR

Diligence of CSR initiatives is important to ensure effective implementation of planned strategy and to determine future action plans. Each company can design measuring strategies based on their selected CSR focus areas. Some basic indicators to measure different CSR areas are elucidated as follows:

Monitoring

(a) Should be done periodically
(b) Collecting data of the performance
© assess the progress
(d)Corrective action, in case of deviation/ delay
(f) Concurrent/final

Impact assessment
Any CSR project/activity should have some impact, big or small. Impact refers to success of the activity with relation to the target.it is confined to the target beneficiaries. In order to know the impact, an impact analysis study is supposed to be made, which would compare the achieved results with the desired result. In order to get real picture, it is the following issues needs consideration.
(a) Should preferably done by an independent agency
(b) Focused on the impact only
(c) Done immediately after the benefit given
(d) Should be data based

Impact assessment helps in formulating future action plan, review of the policy and suggest corrective action.

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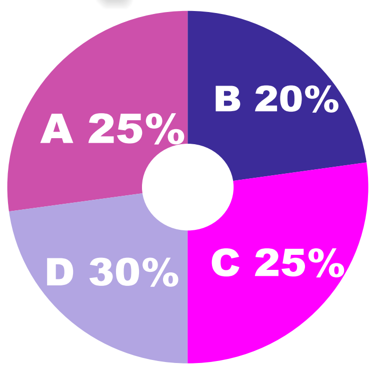
STRATEGIC FINANCIAL MANAGEMENT (SFM)

Dr. Swapan Sarkar,
Assistant Professor
Department of Commerce,
University of Calcutta
He can be reached at:
swapansarkar22@gmail.com

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**
- **Traditional Technical Tools (contd..)**
- **Relative Strength Index (RSI)**

Stock prices tend to move more or less in tandem with the overall market trend, represented by a market index. When the price chart of an industry, or an individual stock diverts from the course chartered by an index, the concept of relative strength can be used to study such divergence. Relative Strength (RS) refers to the ability of an industry or stock to outperform the market at turning points. Relative strength arises out of inherent merit of an industry or stock to recover from a bear market or to peak out earlier than most of the stocks trading in the market.

RSI is calculated by the following formula:
RSI = 100 – 100 / (1 + RS)
RS = Relative Strength = AvgU / AvgD
AvgU = average of all up moves in the last N days
AvgD = average of all down moves in the last N days
N = the period of RSI
Consider the following illustration.

Calculation of 9-day RSI of X Ltd.

Date	Price	Gain	Loss
March 4	300	-	-
6	304	4	-
7	319	15	-
8	317	-	2
11	319	2	-
12	333	14	-
13	331	-	2
14	332	1	-
18	348	16	-
19	346	-	2
		52/9 = 5.78	6/9 = 0.67

RS = 5.78/0.67 = 8.63
RSI = 100 – 100/(1+8.63) = 100 – 10.38 = 89.62
RSI may be calculated for any number of days such as 5, 7, 9 or 14 days. If the period considered is longer, the possibility of getting the wrong signal is reduced. The default look-back period for RSI is 14, but this can be lowered to increase sensitivity or raised to decrease sensitivity. 10-day RSI is more likely to reach overbought or oversold levels than 20-day RSI. RSI is considered overbought when above 70 and oversold when below 30. These traditional levels can also be adjusted to better fit the security or analytical requirements. The broad rule is, if RSI crosses 70, there may be downturn and it is time to sell. If RSI is below 30, it is the time to pick up the script.

If the share price is falling and the RSI is rising, a divergence is said to have occurred. Divergences signal a potential reversal point because directional momentum does not confirm price. A bullish divergence occurs when the underlying security makes a lower low and RSI forms a higher low. RSI does not confirm the lower low and this shows strengthening momentum. A bearish divergence forms when the security records a higher high and RSI forms a lower high. RSI does not confirm the new high and this shows weakening momentum.

- **Moving Averages**

While trends in share prices can be studied for possible patterns, sometimes it may so happen that the prices appear to move rather haphazardly, and be very volatile. Using moving averages can help under such circumstances. A moving average is a summary measure of price movement which reduces the distortions to a minimum by evening out the fluctuations in share prices. The underlying trend in prices is thus clearly discernible when moving averages are used.

The three basic types of moving averages are:

a. Simple moving average,
b. Weighted moving average,
c. Exponential moving average.

a. Simple Moving Average (SMA)

A simple moving average is easy to construct and is widely used by technical analysts. To construct a moving average, the time span of the average has to be first determined. A 30-day moving average, averages out every fluctuation occurring over all the possible 30-day time spans over the period under observation. To construct a 100-day SMA for instance, the prices observed over the first 100 days are first summed up and divided by hundred to obtain a simple average. This is the first value for constructing a 100-day SMA. To obtain the next value, the price prevailing on the 1st day is excluded, while including the price on the 101st day. This represents the next 100-day period. The average of these observations is the next value of 100-day SMA. This process is repeated for the time period one intends to cover. The following table illustrates the computation of 100-day SMA of the market index.

Calculation for 100-day Simple Moving Average

Day	Index (1)	100-day Total (2)	Index 100 days ago (3)	100 days SMA (4)
1	3469.40	339796.80	3409.85	3397.968
2	3425.88	339812.70	3384.99	3398.127
3	3364.71	339792.60	3367.55	3397.926
4	3316.00	339741.60	3399.36	3397.416
5	3280.06	339623.50	3388.48	3396.235
6	3193.77	339430.70	3359.27	3394.307

The choice of time span is very important in constructing moving averages. If prices move in cycles, say over 2 years, a 750-day moving average will smoothen out all intermediate trends. A 10-day moving average will represent many minor fluctuations present on the price line, and would be of little use in determining tops and bottoms of a trend. Lesser the time span, more sensitive the moving average and vice versa. A moving average, therefore, should provide an optimum trade-off between over sensitivity and delay in identifying reversals. A 300-day moving average is widely used by analysts, and is believed to represent an optimum span.
The importance of the choice of time span is crucial. The moving average with longer time span turns much later than those with shorter spans.

Technical analysts observe moving averages more for 'crossovers' (price chart over the moving average or vice versa). The following are the important principles useful in this regard:

(i). When the moving average rises above the price line, a reversal in bullish trend is signaled.
(ii). The price line that falls below a rising moving average only indicates a secondary reaction and need not signal a trend reversal. Similarly, a price line that rises above a falling moving average is an indication to sell.
(iii). A moving average represents a smoothened trend and therefore, also acts as a support/resistance line.
(iv). If the moving average is flat or has already begun to change direction, a crossover by the price line is a fairly reliable indicator of trend reversal.
(v). The significance of a crossover signal depends, to a large extent, on the time span covered by a moving average.

b. Weighted Moving Average (WMA)

A weighted moving average is weighted in favor of the most recent observations, and therefore, turns earlier than the simple moving average.
One of the simpler methods of weighing, which is also widely used, is to multiply the first set of observations by 1, the next set by 2, the third by 3 and so on. The values thus obtained are added, and the sum is divided not by the number of observations., but by the total of the weights. This method, however, gets cumbersome and laborious when the time span of the average is long.

c. Exponential Moving Average (EMA)

Averages constructed over a longer time span have higher utility in technical analysis. But a simple moving average constructed over a long-time span lags the price trend. An exponential moving average provides a short cut method of weighting. This method also provides

more weightage to the recent data.
The procedure for computing the EMA can be explained with the help of an example.

Day	Index	EMA for previous day	(1) - (2)	(3) x 0.02	EMA = (2) ± (4)
	(1)	(2)	(3)	(4)	(5)
1	3469.40	—	—	—	3397.793*
2	3425.88	3397.79	28.09	0.5618	3398.3518
3	3364.71	3398.3518	-33.6418	-0.67283	3397.678
4	3316.00	3397.678	-81.678	-1.6335	3396.044
5	3280.06	3396.044	-115.984	-2.319	3393.724
6	3193.77	3393.724	-199.954	-3.999	3389.7249

* The 100-day SMA on day 1 is posted here.
To construct a 100-day moving average, the first step is to compute a simple average for the first 100 days (the first value in column 5). The value is used as = starting point at column 2. The index value for the 101st day is computed with this value and the difference is shown in column 3. The exponent for the 100-day EMA is calculated as 2/100 = 0.02. The difference obtained in column 3 is multiplied by the exponential 0.02, and posted in column 4. The EMA value for the next 10* days (excluding the first day and including the 101st day) would be the EMA value in column 2 plus or minus the product obtained in column 4, depending upon whether the difference in column 2 is negative or positive. The procedure is re for each succeeding day.

The EMA, thus, provides a smooth base for analysing price trends, exponent is used, it should be remembered that a 100-day EMA would be sensitive as a 300-day EMA, the exponent of the former being twice the of the latter. If it is found that the EMA is very sensitive, the time span can be extended. Alternatively, the EMA can be further smoothened by constructing another EMA for the values first obtained, using a further exponent.

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STRATEGIC COST MANAGEMENT-DECISION MAKING (SCMD)

CMA (Dr.) Sreehari Chava
Cost & Management Consultant,
Nagpur, Maharastra,
He can be reached at:
sreeharichava@yahoo.co.in

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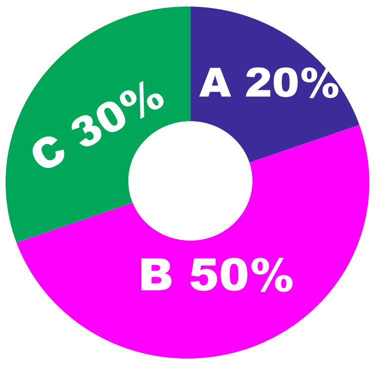


Syllabus Structure

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:

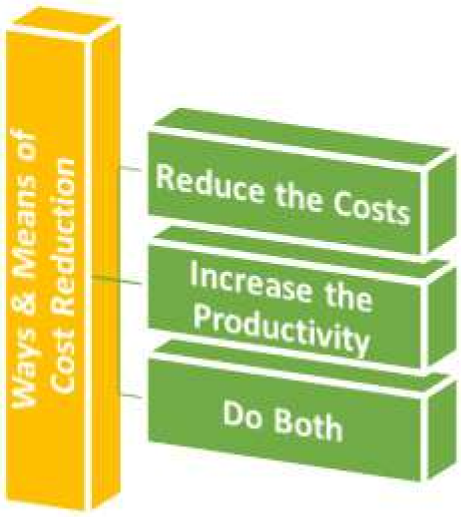
The Strategic cost management framework provides a clear plan of attack for addressing costs and decisions that affect them. It helps to get answers on:

- 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?

Cost Reduction Practices

01.00: Cost Reduction

The term 'Cost Reduction' refers to the attempts to reduce the costs. Cost reduction may be defined as the real and permanent reduction in the unit costs of goods manufactured or services rendered without impairing their suitability for the use intended. Cost reduction would mean maximization of profits by reducing costs through economies and savings in all sorts of costs, viz. could it be of manufacturing, administration, selling and distribution, etc.



The goal of cost reduction can be achieved either by reducing the cost per unit or by increasing the productivity or doing both at the same time. Reducing wastages, improving efficiency, searching for alternative materials, and a constant drive to reduce costs, are some examples which can lead to cost reduction. Worth mentioning is that cost reduction efforts shall be continuous and incessant.

Optimum utilisation of the available resources is one of the significant means of cost reduction. Furnished here under are two such instances drawn from the experiences of senior CMAs.

02.00: Ichalkaranji Power-Loomers minimise their Fixed Cost Burden

Ichalkaranji is a moderate industrial town located in the western parts of Maharashtra. The place is well known for skilled weavers and a prosperous power-loom industry. Hence, the town has acquired the fame as the Manchester of Maharashtra.

The power-loom is considered as a diligent economic model between well-organized mill sector and outdated handlooms. An important characteristic of the power loom industry in Ichalkaranji is that most of the looms are owned by the local micro entrepreneurs with an average holding of about four looms.

The loom owners were able to reduce their slack season idle costs by about eighty per cent and the seed company was able to reduce its packing material costs by about twenty percent.

One power-loom unit, on an average, produces about 80 metres of grey cloth per day from either cotton or polyester yarn. The cloth is used as the primary material by the textile and garment industries. As the textile industry is prone to seasonal fluctuations, i.e., surging in sales during festive and marriage seasons and declining sales in slack seasons; the power-looms also used to suffer from lack of buyers during the slack season.

In order to retain the skilled labour during the slack season, the loom owners used to pay wages to the workers even when there is no work. As such, the industry is burdened with considerable retaining costs (i.e. idle labour costs) which tend to remain fixed for the entire slack-period. These of the idle costs used to cripple the earnings of the loom owners severely.

Grey cloth is one of the primary packing materials for the agriculture-seeds because of the fact that most of the seeds are packed in cloth bags. One of the renowned seed companies, which was having international presence, was looking for ways and means of reducing its packing costs. The company came to know about the slack season cost-burden of the power loom industry of Ichalkaranji. The company has also observed that peak demand for the seed packing coincides with the slack-season of the power looms.

The seed company came up with a pricing proposal for buying the cloth from the power loom owners during the slack season on variable cost-plus basis whereby the fixed cost burden of the looms would be reduced substantially. The loom owners came forward willingly and supplied the cloth to the seed company at fairly cheaper prices.

The end result was a win-win cost reduction both for the loom owners as also the seed company. The loom owners were able to reduce their slack season idle costs by about eighty per cent and the seed company was able to reduce its packing material costs by about twenty percent.

03.00: MEC multiplies its profit through Outsourcing

MEC is a medium scale electronic manufacturer located in Central India. Its annual turnover used to be about five crores of rupees. The components used in the company's products could be conveniently divided into A, B and C; A items accounting for ten percent in quantity and seventy percent in value, B items twenty percent in quantity and twenty percent in value and C items seventy percent in quantity and ten percent in value. Over a period of time, the company established a niche for quality in its field and started experiencing an upswing.

The productivity as also the profitability of MEC and its vendors were multiplied by means of prudent deployment and optimum utilisation of their labour resources.

For the year under consideration the company was flooded with profitable orders worth twenty crores of rupees, i.e. four times of its existing turnover. After a diligent review, the management felt that its existing capacity can, at best, be stretched by fifty percent whereby orders to the extent of Rs.7.5 crore can be executed.

The management had several sessions of brainstorms. The executives realised that the company is capable of producing the entire quantity of A & B items needed for the orders; but the challenge was about C items. Assembly labour was identified as the major limiting factor for the production of C items.

The deliberations were extended to the vendors and a viable solution brought out. The vendors were willing to undertake the work of assembling the C items, if they were given to them in SKD (Semi Knocked Down) form. The proposition was readily accepted.

At the end MEC was able to execute the orders worth Rs. 20 crores successfully by outsourcing the assembly operations relating to C items. The productivity as also the profitability of MEC and its vendors were multiplied by means of prudent deployment and optimum utilisation of their labour resources.

04.00: Assimilation

The tools and techniques of cost reduction could be many; but the key is successful adaptation and implementation. Cost behaviour, too, plays a significant role in cost reduction endeavours. The approach, methods, and duration targets could be different for variable costs as compared to fixed costs. Variable costs may be prone to reduction even on short term basis whereas as fixed cost reduction may warrant long term strategies. In the ultimate, it is the total cost that shall be reduced on a permanent basis.

05.00: Quick Take

Cost Reduction is the first step towards Cost Leadership!

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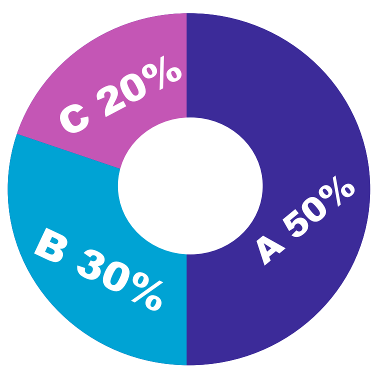
DIRECT TAX

LAWS AND INTERNATIONAL TAXATION (DTI)

CA Vikash Mundhra
He can be reached at:
vikash@taxpointindia.com

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.

Basics of Transfer Pricing

"Transfer Pricing is not an exact science but does require the exercise of judgement on the part of both the tax administration and taxpayer"

Commercial transactions between the different parts of the multinational groups may not be subject to the same market forces shaping relations between the two independent firms. One party transfers goods or services to another for a price. That price is known as "transfer price". This may be arbitrary and dictated, with no relation to cost and added value, diverge from the market forces. Transfer price is, thus, a price which represents the value of goods or services between independently operating units of an organisation. But, the expression "transfer pricing" generally refers to prices of transactions between associated enterprises which may take place under conditions differing from those taking place between independent enterprises. It refers to the value attached to transfers of goods, services and technology between related entities. It also refers to the value attached to transfers between unrelated parties which are controlled by a common entity.

Suppose a company A purchases goods for ₹ 100 and sells it to its associated company B in another country for ₹ 200, who in turn sells in the open market for ₹ 400. Had A sold it direct, it would have made a profit of ₹ 300. But by routing it through B, it restricted it to ₹ 100, permitting B to appropriate the balance. The transaction between A and B is arranged and not governed by market forces. The profit of ₹ 200 is, thereby, shifted to the country of B. The goods is transferred on a price (transfer price) which is arbitrary or dictated (₹ 200), but not on the market price (₹ 400).

Thus, the effect of transfer pricing is that the parent company or a specific subsidiary tends to produce insufficient taxable income or excessive loss on a transaction. For instance, profits accruing to the parent can be increased by setting high transfer prices to siphon profits from subsidiaries domiciled in high tax countries, and low transfer prices to move profits to subsidiaries located in low tax jurisdiction. As an example of this, a group which manufacture products in a high tax countries may decide to sell them at a low profit to its affiliate sales company based in a tax haven country. That company would in turn sell the product at an arm's length price and the resulting (inflated) profit would be subject to little or no tax in that country. The result is revenue loss and also a drain on foreign exchange reserves.

Computation of income from international transaction or specified domestic transaction having regard to arm's length price [Sec. 92]

The provisions are as under:

Provisions	Example	Treatment	Impact on income
Any income arising from an *international transaction* shall be computed having regard to the *arm's length price*.	X Ltd., resident, sold goods or services to its associated enterprises, XY Plc. (a foreign company), for ₹ 5 lacs whereas the arm's length price of such goods or services is ₹ 9 lacs	While computing income of X Ltd., ₹ 9 lacs shall be considered as sale value	Income of X Ltd. will be increased by ₹ 4 lacs.
The allowance for any expense or interest arising from an international transaction or specified domestic transaction shall also be determined having regard to the arm's length price.	R Ltd. takes a loan of ₹ 20 lacs from an associated enterprise in Ireland @ 20% p.a. whereas the arm's length rate of interest is 12% p.a.	Interest @ 12% p.a. shall be allowed as deduction to R Ltd.	Income of R Ltd. will be increased by ₹ 1,60,000/-
Where in an international transaction or specified domestic transaction, • two or more *associated enterprises* • enter into a mutual agreement or arrangement for the apportionment of, or any contribution to, any cost incurred • in connection with a benefit, service or facility provided to any such enterprises,	An enterprise in Germany makes research on a new product and incurred ₹ 50 lacs. Out of this, ₹ 40 lacs has been allocated to its Indian associated enterprises dealing in the same product.	While computing income of Indian enterprise, it will be required to be examined whether the Indian enterprise is deriving proportionate benefit to the research expenditure allocated	If no such benefit is available to the Indian enterprise, total income of such enterprises is suitably increased by disallowing proportionate allocated cost.

the cost apportioned to (contributed by), any such enterprise shall be determined having regard to the arm's length price of such benefit, service or facility.			
The provisions (in any of aforesaid situation) shall not apply in a case where the computation of income or the determination of the allowance for any expense or interest or the determination of any cost or expense allocated or contributed has the *effect of reducing the income* chargeable to tax or increasing the loss, as the case may be, computed on the basis of entries made in the books of account in respect of the previous year in which the international transaction or specified domestic transaction was entered into.	X Ltd., resident, sold goods or services to its associated enterprises, XY Plc. (a foreign company), for ₹ 5 lacs whereas the arm's length price of such goods or services is ₹ 3 lacs	The provision of transfer pricing is not applicable	No Impact

Meaning of associated enterprise [Sec. 92A]

Associated enterprise, in relation to another enterprise, means an enterprise:

(a) which participates, directly or indirectly, or through one or more intermediaries, in the *management* or *control* or *capital* of the other enterprise; or
(b) in respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.

Deemed associated enterprise [Sec. 92A(2)]

For the above purpose, two enterprises shall be deemed to be associated enterprises if, at any time during the previous year fulfill any of the following conditions (if one of following conditions are not satisfied, then mere participation in management or control or capital of the other enterprise, etc. shall not make them associate):
(a) one enterprise holds (directly or indirectly) shares carrying not less than 26% of the voting power (i.e., equity shares in case of company) in the other enterprise; or
(b) any person or enterprise holds (directly or indirectly) shares carrying not less than 26% of the voting power in each of such enterprises; or
(c) the manufacture or processing of goods or articles or business carried out by one enterprise is *wholly* (not partially) dependent on the use of know-how, patents, copyrights, trade-marks, licences, franchises or any other business or commercial rights of similar nature, or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or in respect of which the other enterprise has *exclusive* rights; or
(d) 90% or more of the raw materials and consumables required for the manufacture or processing of goods or articles carried out by one enterprise, are supplied by the other enterprise **or** by persons specified by the other enterprise, **and** the prices and other conditions relating to the supply are influenced by such other enterprise; or
(e) the goods or articles manufactured or processed by one enterprise, are sold to the other enterprise or to persons specified by the other enterprise, and the prices and other conditions relating thereto are influenced by such other enterprise; or
(f) where one enterprise is controlled by an individual, the other enterprise is also controlled by such individual or his relative or jointly by such individual and relative of such individual; or
(g) where one enterprise is controlled by a Hindu undivided family, the other enterprise is controlled by a member of such Hindu undivided family, or by a relative of a member of such Hindu undivided family, or jointly by such member and his relative; or
(h) where one enterprise is a firm, association of persons or body of individuals, the other enterprise holds not less than 10% interest in such firm, association of persons or body of individuals; or
(I) a loan advanced by one enterprise to the other enterprise constitutes not less than 51% of the **book value** of the total assets of the other enterprise; or
***Taxpoint**: Revaluation of asset shall not be ignored.*
(j) one enterprise guarantees not less than 10% of the total borrowings of the other enterprise; or
(k) more than $\frac{1}{2}$ of the board of directors or members of the governing board, **or** one (not $\frac{1}{2}$ of total number of executive director) or more executive directors or executive members of the governing board of one enterprise, are **appointed** by the other enterprise; or
***Taxpoint**: Mere power to appoint director is not sufficient, such power must be exercised.*
(l) more than $\frac{1}{2}$ of the directors or members of the governing board, **or** one or more of the executive directors or members of the governing board, of each of the two enterprises are **appointed** by the same person or persons; or

(m) there exists between the two enterprises, any relationship of mutual interest, as may be prescribed.

Equity Holding	Management	Activities	Control
1. >= 26% direct / indirect holding by enterprise OR 2. By same person in each enterprise 3. Loan >= 51% of Total Assets 4. Guarantees > = 10% of debt > 10% interest in Firm / AOP / BOI	6. Appointment > 50% of Directors / one or more Executive Director by an enterprise OR Appointment by same person in each enterprise	8. 100% dependence on use of intangibles for manufacture / processing / business 9. Direct / indirect supply of > = 90% Raw Materials under influenced prices and conditions Sale under influenced prices and conditions	11. One enterprise controlled by an individual and the other by himself or his relative or jointly 12. One enterprise controlled by HUF and the other by - a member of HUF - his relative or Jointly by member and relative

Computation of arm's length price [Sec. 92C]

* The arm's length price in relation to an international transaction or specified domestic transaction shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe, namely:

Transaction Based Methods

a. comparable uncontrolled price method;
b. resale price method;
c. cost plus method;

Profit Based Methods

d. profit split method;
e. transactional net margin method;
f. such other method as may be prescribed by the Board.

Vol: 7, No.: 1.
January 2022, Issue

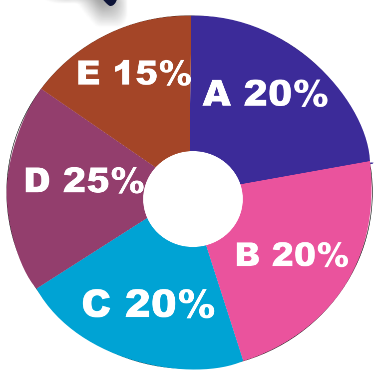
YEARS OF CELEBRATING THE MAHATMA

GROUP: iv, PAPER: 17

CORPORATE FINANCIAL REPORTING (CFR)

Dr. Ananda Mohan Pal
Professor,
Department of Business Management,
The University of Calcutta,
He can be reached at:
apal59@gmail.com

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

Some Other Cases of Business Combinations for Recapitulation

In the December 2021 issue we discussed how the events like Absorption, Amalgamation and External Reconstruction are treated under Ind AS 103 with the help of illustrations.

In this January 2022 issue we are discussing some other cases of business combinations for recapitulation.

1. A business combination is a transaction or other event in which an acquirer obtains **control** of one or more businesses. When after business combination, acquiree continues to exist as a subsidiary, it is to be recorded in the books of the acquirer in two sets, one for consolidated accounts (which has been prescribed under acquisition method of Ind AS 103) and the other for its separate financial statements i.e., for its stand-alone accounts.
   Thus, when A Ltd. purchases 60% shares of B Ltd.,A Ltd. is the acquirer company and B Ltd. is the acquiree company and no accounting is required in the books of B Ltd. but in the books of A Ltd., accounting is required in two sets of accounts:
   (I)In stand-alone set as stated below:
   (Note: there is no application of Ind AS 103)
   Investment in shares in B Ltd. Dr.
   To, Consideration Cr.

   (II) In consolidated set **Acquisition Method** of Ind AS 103 is applied.
   Accordingly, the acquirer company in its financial statements:

	Recognizes as	Measures
(a)	the **identifiable** assets acquired, and	at their fair values at the acquisition date
	the **identifiable** liabilities assumed	
	and any non-controlling interest (NCI) in the acquiree	at its **fair value** at the acquisition date, **or**
		at the non-controlling interest's proportionate share in **fair value of the acquiree's identifiable net assets**
(b)	the goodwill acquired in the business combination (A – B) or a gain from a bargain purchase (B – A)	A = Fair value of consideration transferred + Recognized amount of any NCI in acquiree + Fair value of (if any) previously held equity interest in the acquiree
		B = Net of acquisition-date amounts of the identifiable assets acquired and liabilities assumed.
©	The investor may have previously-held equity interest in acquiree (investee). Then, previously held investment in acquiree has to be cancelled.	at **fair value** at the date of acquisition.

Thus,entries in the books of the acquirer:
Identified Assets of Acquiree Dr.
Goodwill (if any) Dr.
To, Consideration Cr.
To, Identified Liabilities Cr.
To, Non-controlling Interest Cr.
To, Previously-held equity interest in Acquiree Cr.
To, Gain from a bargain purchase (if any) Cr.

1. Suppose A Ltd. acquired 60% shares in B Ltd. Thus, A Ltd. is the acquirer and B Ltd. is the acquiree. But there may be a complication. If A Ltd. had 100000 shares and issued further 150000 shares as consideration for acquiring 60% control of B Ltd,

ultimately shareholders of B Ltd. were holding 150000 shares out of 250000 shares of the combined entity. In such situation and in similar other situations, the **legal acquirer issuing shares will be considered as accounting acquiree** and under Ind AS 103 it is called **Reverse Acquisition**. In the consolidated set, assets and liabilities of the accounting acquiree will be recognized at fair value and that of the legal acquiree at carrying amount.

2. If in a business combination all the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory, it is a **business combination under common control**. Appendix C of Ind AS 103 deals with accounting for combination of entities or businesses under common control.

   Common control business combinations will include transactions, such as transfer of subsidiaries or businesses, between entities within a group. The extent of non-controlling interests in each of the combining entities before and after the business combination is not relevant to determine whether the combination involves entities under common control. This is because a partially-owned subsidiary is nevertheless under the control of the parent entity.

   Business combinations involving entities or businesses under common control shall be accounted for using the **pooling of interest** method. The pooling of interest method is considered to involve the following:

   (i) The assets and liabilities of the combining entities are reflected at their carrying amounts.

   (ii) No adjustments are made to reflect fair values, or recognize any new assets or liabilities.

   (iii) The equity share capital will be recorded at nominal value only. Consideration in excess of equity share capital will be recorded as goodwill (Capital reserve in case of deficiency).

   (iv) The other equity of the transferor shall be carried by the transferee in the same form in which they appeared in the financial statements of the transferor.

3. In business combination under Ind AS 103, we find measurement of goodwill/ bargain purchase and non-controlling interest which are required for preparation of consolidated financial statements. Again, Ind AS 110 prescribes principles of preparation and presentation of consolidated financial statements when one entity controls one or more other entities.Thus, for accounting of groups, i.e., for parent and its subsidiaries, we may require to apply both Ind AS 103 and Ind AS 110.

In the next issue we may take up some numerical examples under Ind AS 103. Thereafter, we shall take up Ind AS 110 where, we shall apply Ind AS 103 also.

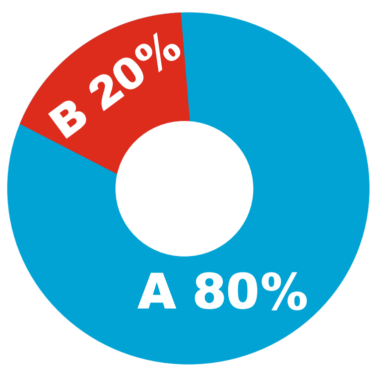
YEARS OF CELEBRATING THE MAHATMA

GROUP: iv, PAPER: 18

INDIRECT TAX LAWS & PRACTICE (ITP)

CMA Rana Ghosh
Chief Executive Officer,
Institution of Estate Managers & Appraisers
He can be reached at:
ranaham@rediffmail.com

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
- GST registration and cancellation
- Exempted supply and composition scheme
- Tax invoice and e invoice
- QR code in e invoice
- Bill of Supply
- Furnish of return
- Audited accounts
- Sale by auctioneer

INDIRECT TAX

Choose the correct option from the followings –

1. **Where a registered person has applied for cancellation of registration under rule 20,** the registration shall be deemed to be suspended
   (a) from the date of submission of the application
   (b) the date from which the cancellation is sought
   (c) from the date of submission of the application or the date from which the cancellation is sought, whichever is later
   (d) suspend the registration of such person with effect from completing all taxable supply.

2. **The GST registrations can be voluntarily cancelled**
   (a) Within six month of the registration
   (b) Within nine month of the registration
   (c) Within one year of the registration
   (d) After one year of registration

3. **As per section 30(1) of the CGST Act, 2017, any registered person, whose registration is cancelled by the proper officer may apply to such officer for revocation of cancellation from the date of service of the cancellation order within**
   (a) 15 days
   (b) 30 days
   (c) 45 days
   (d) 60 days

4. **if a registered person is dealing only in exempted supplies or is availing the composition scheme (composition dealer), then such a registered person needs to issue a**
   (a) Proforma invoice
   (b) Tax invoice
   (c) Bill of supply
   (d) Challan

5. **Invoice can be considered an important indicator of the**
   (a) Time of supply
   (b) Taxability of the goods
   (c) Value of the goods
   (d) Identity of the registered dealer

6. **Which of the following is incorrect in relation to "A registered person may not issue a Tax Invoice"**
   (a) Value of the goods/services/both supplied < Rs200
   (b) the recipient is registered under composite scheme
   (c) the recipient does not require such invoice.
   (d) the recipient is unregistered

7. **w.e.f. 1-1-2021, Government has mandated e-invoicing for taxpayers having aggregate turnover exceeding (in any preceding financial year from 2017-18 onwards)to be implemented vide Notification No. 88/2020 CT dated 10-11-2020**
   (a) Rs 100 crores
   (b) Rs 200 crores
   (c) Rs 300 crores
   (d) Rs 500 crores

8. Which of the following e –invoice is not required
- (a) Supplies to registered persons (B2B)
- (b) Supplies to SEZs (with/without payment),
- (c) Input Service Distributor (ISD)
- (d) Deemed Exports

9. Which of the mode is not presently operational for generation of e –invoice
- (a) API based (integration with Taxpayer's System directly)
- (b) API based (integration with Taxpayer's System through GSP/ASP)
- (c) Free Offline Utility ('Bulk Generation Tool', downloadable from IRP)
- (d) Web-based / mobile app-based

10. Which of the following will not be the part of the QR code that consist of particulars of e-invoice
- (a) IRN Generation time
- (b) GSTIN of Recipient
- (c) Date of generation of invoice
- (d) Number of line items

11. State the correct statement from the below
- (a) cancellation request of IRN / Invoice can not be triggered through 'Cancel API'
- (b) IRN number of a cancelled can be used again
- (c) partial cancellation of reported e-invoice is not allowed
- (d) While transporting goods, wherever the e-way bill is needed, , the requirement is not continues to be mandatory

12. If a registered person is supplying taxable as well as exempted goods/services to an unregistered person, then he can issue a
- (a) Tax invoice
- (b) Bill of Supply
- (c) Challan
- (d) Invoice cum bill of supply

13. Which of the following statement is incorrect in relation to Bill of supply
- (a) HSN Code of goods or Accounting Code for Services
- (b) Name, address and GSTIN or UIN, if registered, of the recipient
- (c) Value of supply of goods or services or both without taking into account discount or abatement, if any
- (d) Signature or digital signature of the supplier or his authorized representative

14. As per Section 31(5) of the CGST Act, 2017, subject to the provisions of clause (d) of Sub section (3) in case of continuous supply of services which of the below Mentioned statement is not correct
- (a) where the due date of payment is ascertainable from the contract, the invoice shall be issued on or before the due date of payment
- (b) where the due date of payment is not ascertainable from the contract, the invoice shall be issued after the time when the supplier of service receives the payment
- (c) where the due date of payment is not ascertainable from the contract, the invoice shall be issued before or at the time when the supplier of service receives the payment
- (d) where the payment is linked to the completion of an event, the invoice shall be issued on or before the date of completion of that event

15. State whether the following statement are true or falls in relation to Goods sent/taken out of India for exhibition or on consignment basis for export promotion
1) Supply treated as sale on approval basis.
2) A bill of supply to be issued
3) It is not a zero-rated supply. Hence, no need to execute Bond/LUT
4) Not a supply if the gods are returned ≤6months from the date of removal.

Options –
- (a) True, True, True, False
- (b) False. False, False, True
- (c) True, False, True, True
- (d) False, True, False, True

16. Presently which one of the following will not be taken as content of a revised tax invoice and credit or debit note
- (a) Signature or digital signature of the supplier or his authorized representative
- (b) Nature of the document
- (c) Name, address and GSTIN or UIN, if registered, of the recipient

(d) Serial number and date of the corresponding tax invoice or, as the case may be, bill of supply

17. Every registered person is required to furnish a return for each tax period.

(a) self-assess the taxes payable
(b) for financial year only
(c) based on inward and outward supply
(d) input credit avail

18. Which of the following statement is not correct

(a) Place of business now also includes a warehouse, a godown, or any other place where a taxable person stores in goods, supplies or receives goods or services or both.
(b) In case, the goods have reached the transporter's godowni.e additional place of business then the transportation under the e-way bill will be deemed to be concluded. There will be no need of an extension of e-way bill's validity.
(c) Presently whenever the goods move from the transporter's godown to the recipient taxpayer's any other place of business, a valid e-way bill is not required.
(d) The recipient will be required to maintain books of accounts in relation to the goods stored at the godown of the transporters.

19. Every registered person whose turnover crosses specific limit shall furnish a copy of audited annual accounts and a reconciliation statement, duly certified, in

(a) FORM GSTR-7C
(b) FORM GSTR-8C
(c) FORM GSTR-9C
(d) FORM GSTR-10C

20. Regarding Accounts And Records to be maintained by Principal And auctioneer in case of auction of tea, coffee, rubber etc which statement is incorrect

(a) The principal and the auctioneer may declare the warehouses, where such goods are stored, as their additional place of business
(b) The buyer is also required to disclose such warehouse as his additional place of business if he wants to store the goods purchased through auction in such warehouses
(c) For the purpose of supply of tea through a private treaty, the principal and an auctioneer may not require to comply with the provisions as per the GST Law
(d) Principal and the auctioneer shall be eligible to avail input tax credit subject to the fulfillment of other provisions of the CGST Act

ANSWERS

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

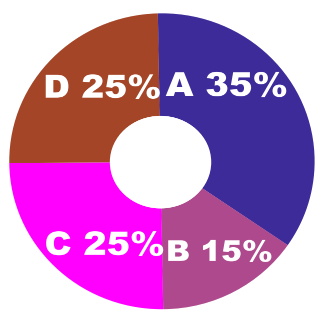
YEARS OF CELEBRATING THE MAHATMA

GROUP: iv, PAPER: 19

COST & MANAGEMENT AUDIT (CMAD)

CMA S S Sonthalia
Practicing Cost Accountant
He can be reached at:
sonthalia_ss@yahoo.co.in

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

Filing of Cost Audit Report in XBRL in terms of Companies (Cost Records and Audit) Rules, 2014 as Amended

Introduction

Extensible Business Reporting Language (XBRL) is the open international standard for digital business reporting. It is used around the world in more than 50 countries and a step towards paperless reporting with more useful, more effective and more accurate digital version of reporting. XBRL is like the change from the film photography to digital photography.

The Companies (Cost Records and Audit) Rules, 2014 as amended vide Notification dated 14.07.2016 require cost audit report to be filed with MCA in XBRL Format. The Sub Rule 6 of Rule 6 of Companies (Cost Records and Audit) Rules, 2014 has been amended which read as follow:

> **"(6) Every company covered under these rules shall, within a period of thirty days from the date of receipt of a copy of the cost audit report, furnish the Central Government with such report along with full information and explanation on every reservation or qualification contained therein, in Form CRA-4 in Extensible Business Reporting Language format in the manner as specified in the Companies (Filing of Documents and Forms in Extensible Business Reporting language) Rules, 2015 along with fees specified in the Companies (Registration Offices and Fees) Rules, 2014.".**

The advantage of XBRL reporting is that the people consuming or utilising the information are confident that the information contained or the data provided to them can be consumed and analysed accurately and conforms to a set of pre-defined definitions.

The Government of India vide notification mandated that the Cost Audit Report filed in terms of Companies (Cost Records and Audit) Rules 2014 (CCRA Rules 2014), should be on XBRL format. Accordingly, the Cost Audit Report is filed with MCA in XBRL format as an attachment to the form CRA 4 along with the prescribed filing fee. It may be mentioned that as per the provisions of CCRA Rules 2014, the CRA 4 is needed to be filed with MCA, within 30 days of receipt of the Cost Audit Report from the Auditor.

Hardware and Software Requirement

In order to convert the Cost Audit Report, one needs to have a XBRL software which can be obtained from MCA portal / XBRL international / Authorised Vendor. Further, the computer should have the following operating system to run the software:

a) Operating system – Windows XP / Windows Vista / Windows 7
b) Minimum 2GB RAM and Minimum 28 MB free drive space
c) Processor speed of 1GHz
d) JAVA - JRE version of 1.6 or 1.7

Steps for filing of Cost Audit Report in XBRL Format

a) **Creation of XBRL Instance Document.**
For creation of Instance Document, the information contained in the Cost Audit Report of a company need to be tagged with XBRL Taxonomy elements. After proper tagging and filing of information accurately, the file is converted into XML file. However, if there is any error or mismatch in filing of figures / tagging, the errors are reflected in the systems while generating the XML document. On correcting these information, the Instance Document in XML file is generated.

b) **Download XBRL validation tool**
Validating the instance document with the MCA XBRL validation tool (for costing taxonomy) is a pre-requisite before filing the Cost audit report and Compliance report on MCA portal. . The MCA XBRL validation tool (for costing taxonomy) can be downloaded from the XBRL website of the Ministry (www.mca.gov.in/XBRL). Before Validating an Instance document, the applicable taxonomy is to be selected by the user from the drop down option "taxonomy".

c) **Load the Instance Document**
To load the instance document, you need to click the open button, select the instance document and open it.

d) **Validate the instance document**
The next step is to validate the instance document. The following validations are performed by the tool-
Validating that the instance document is as per the latest and correct version of taxonomy prescribed by MCA
All mandatory elements have been entered

Validations relating to XBRL technical Specifications as per taxonomy

In case the instance document is not properly created, then the tool will through up the list of errors, in a separate window, and they need to be corrected and validated again for successful uploading of the report.

e) **Pre-scrutiny of the instance document**
Once the instance document is successfully validated from the tool, the next step is to pre-scrutinise the validated instance document with the help of the same tool using internet connection. In the Pre-scrutiny, the system verify the information from MCA21 database.

f) **Convert to PDF and manually verify the contents of the instance document**
Once the instance document has been successfully pre-scrutinized, the next step is to generate PDF by using 'Export to PDF' function in the tool. The company and the cost auditor can use this feature to verify the accuracy of the instance document.

g) **Attach instance document to the form CRA-4 and submit on MCA Portal**
Form CRA-4 is available on the MCA portal. The Form has to be filled up correctly and thereafter, the validated and pre-scrutinised instance document for Cost Audit Report is attached to the Form. The form is signed by authorised representative of the company, pre-scrutinized and then upload. On payment of requisite payment challan is generated

<u>Care to be taken while filling the XBRL</u>

a) While filling the form please ensure that the system has internet connectivity.
b) While filling Company Master, just put the CIN of company and click prefill button. It will auto fill the data. Check the same and click update.
c) While filling the Auditor Master, fill the name of the Auditor, double click the same and it will auto fill the data. Check the form and save.
d) Please ensure that the figures put in Part A Para 4 – Other Income of the Company is same as Part D Para 3 – Serial No 8 – Other Income of the Company.
e) Please ensure that figure put in Part A Para 4 – Total Net Revenue, must tally with Part D Para 3 – Net Revenue from Operation.
f) Please ensure the figure put in Part D Para 3 – Value Added, should tally with Part D Para 4 – Ratio Analysis – Value Added.
g) Please ensure the figure put in Part B Para 2 – Margin as per Cost Statement, must tally with Part D Para 2 – Profit / Loss for Audited Products.
h) Please ensure the figure put in Part D Para 2 – Profit / (Loss) in Financial Accounts should tally with Part D Para 4 – Ratio Analysis – Profit before Tax.
i) For filling information for Related Party Transaction, first fill the details of related parties. For this fill up the CIN of all the Related Parties that are companies and / or PAN of Related Party Firm / Individual. Then click the Fill Party Name and it will auto fill the Related Party Name as per MCA database.

<u>List of Errors and Interpretation</u>

Once the validation has been performed, the list of errors, which may have occurred will be displayed by the tool. An "error" indicates that a mistake has happened, either in respect of the value of an item, or the format in which the value of the item has been entered. For example, the date format 10-05-2018 is not the correct format, and it has to be entered as 10/05/2018.
Other issues are:

a) Issue in net connectivity.

b) 0-100 entered for Percentage Data Type fields

c) Mandatory fields have not been entered.

d) Mandatory line-items of a table are not entered in the instance document.

e) The elements are not entered for any abstract.

f) The elements are not entered for ordered explicit members.

g) The elements are not entered for ordered explicit members.

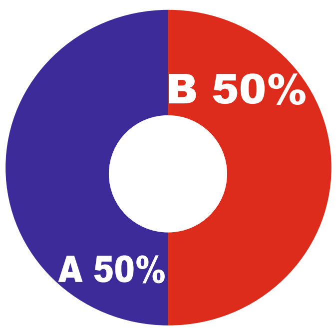
h) The value of element should be provided in at least one of the dimensional members.

Dr. Ashish Kumar Sana
Professor, Department of Commerce
University of Calcutta
He can be reached at:
cu.ashis@gmail.com

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

(Based on Study Material, MTP, RTP and Previous End-Terms Questions)

The Altman Model: Z-Score-A Corporate Failure prediction Model

In 1968, Edward I. Altman developed a Multivariate Model of Corporate Distress Prediction on the basis of Multiple Discriminant Analysis (MDA). He selected 33 failed and 33 non-failed firms, of which 22 Accounting and Non-accounting Ratios, which had been deemed to be the predictors of Corporate Distress, were taken into consideration. Of the 22 Accounting Ratios, he selected 5 ratios which had been deemed as the best predictors of Corporate Distress Prediction.
The purposes of these five selected ratios are as follows:

- To measure liquidity position of the firms.
- To measure reinvestment of earnings of the firms.
- To measure profitability of the firms.
- To measure financial leverage condition of the firms.
- To measure sales-generating ability of firm's Assets.

Hence the Model is:

$$Z = 1.2X_1 + 1.4X_2 + 3.3X_3 + 0.6X_4 + 1.0X_5$$

Where,
Z = Overall Index of Multiple Index Function
X_1 = working capital / total assets. It measures liquid assets in relation to the size of the company.
X_2 = retained earnings / total assets. It measures profitability that reflects the company's age and earning power.
X_3 = earnings before interest and taxes / total assets. It measures operating efficiency apart from tax and leveraging factors. It recognizes operating earnings as being important to long-term viability.
X_4 = market value of equity / book value of total liabilities. It adds market dimension that can show up security price fluctuation as a possible red flag.
X_5 = sales / total assets. Standard measure for total asset turnover (varies greatly from industry to industry).

Analysis of Value of Z-score

(i) If the calculated value of Z-score is greater than 2.99, it is predicted that the firm belongs to non-bankrupt class (i.e., non-failed firm).

(ii) If the calculated value of Z-score is smaller than 1.81, it is predicted that the firm belongs to bankrupt class (i.e., failed firm).

(iii) If the calculated value of Z-score of a firm falls between 1.81 and 2.99 (referred to as Grey Area), it is predicted that the firm consists of both bankrupt and non-bankrupt class (i.e., mixture of failed and non-failed elements) and, therefore, requires further investigation to determine its solvency status.

As per Altman's Multivariate Model of Distress Prediction

(a) If $Z > 2.99$: Non-failed or non-distressed firm

(b) If $Z < 1.81$: Failed or distressed firm

© If $Z \geq 1.81$ but ≤ 2.99: Mixture of failed and non-failed elements which requires further investigation to determine its solvency status.

In 1983, Altman developed a revised Z-score model for privately held firms. "Credit analysis, private placement dealers, accounting auditors, and firms themselves are concerned that the original model is only applicable to publicly traded entities (since X requires stock price data)". The revised Z-scores substitute the book value of equity for the market value in X.

The new Z-score model ratios are listed below:
X_1 = Working capital / total assets
X_2 = Retained earnings / total assets
X_3 = Earnings before interest and taxes / total assets
X_4 = Market value of equity / total liabilities
X_5 = Sales / total assets
A change in the weight factor is also calculated. The revised Z-Score formula follows:

$$Z = 0.717(X_1) + 0.847(X_2) + 3.107(X_3) + 0.420(X_4) + 0.998(X_5)$$

Zones of discrimination:
$Z > 2.99$ – "Safe" Zone
$1.81 < Z < 2.99$ – "Grey" Zone
$Z < 1.81$ – "Distress" Zone

Z- score estimated for manufacturers, industrials, non - manufacturers & emerging markets

Z-Score bankruptcy model: $Z = 6.56X_1+3.26X_2 +6.72X_3+1.05X_4$

X_1= = (Current Assets – Current Liabilities) / Total Assets
X_2== Retained Earnings / Total Assets
X_3= Earnings before Interest and Taxes / Total Assets
X_4= Book Value of Equity/Total Liabilities
Zones of discriminations:

Z > 2.60 – "Safe" Zone

1.1 < Z < 2.60 – "Grey" Zone
Z < 1.1 – "Distress" Zone

MCQs

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

1. **Risk management technique do not include:**
   (a) Trade cycles
   (b) Interest rate risk
   (c) Inflation rate risk
   (d) Exchange risk

2. **Unsystematic risk relates to:**
   (a) Market risk
   (b) Beta
   (c) Inherent risk
   (d) Interest rate risk

3. **Systematic risk is measured by:**
   (a) Alpha
   (b) Beta
   (c) Gamma
   (d) Delta

4. **The risk which is primarily influenced by the level of financial gearing, interest cover, operating leverage, and cash flow adequacy, is called:**
   (a) Financial risk
   (b) Business risk
   (c) External risk
   (d) Exchange risk

5. **One of the forms of risk management mostly practiced by insurance companies is-**
   (a) Probability of Ruin
   (b) Risk reduction
   (c) Risk Pooling
   (d)) Risk Mapping

Answers:

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

Example 1

Using Altman's Multiple Discriminant Function, calculate Z-score of B Ltd., where the five accounting ratios are as follows and comment about its financial position:
Working Capital to Total Assets=0.250
Retained Earnings to Total Assets = 50%
EBIT to Total Assets = 19%
Book Value of Equity to Book Value of Total Debt= 1.65

Sales to Total Assets = 3 times

Solution

As per Altman's Model (1983) of Corporate Distress Prediction,
$Z=0.717\, X_1 + 0.847\, X_2 + 3.107\, X_3 + 0.420\, X_4 + 0.998X_5$
Here, the five variables are as follows:
X_1 = Working Capital to Total Assets = 0.250
X_2 = Retained Earnings to Total Assets = 0.50
X_3 = EBIT to Total Assets = 0.19
X_4 = Book Value of Equity Shares to Book Value of Total Debt = 1.65
X_5 = Sales to Total Assets = 3 times
Hence,
Z-score = (0.717 x 0.25) + (0.847 x 0.50) + (3.107 x 0.19) + (0.420 x 1.65) + (0.998 x 3)
= 0.17925 + 0.4235 + 0.59033 + 0.693 + 2.994
= 4.88
Comment: As the calculated value of Z-score is much higher than 2.9, it can be strongly predicted that the company is a non-bankrupt company (i.e., non-failed company).

150 YEARS OF CELEBRATING THE MAHATMA

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

Updation of E-Mail Address/Mobile:

Students are advised to update their E-Mail id and Mobile Numbers timely so that important communications are not missed as the same are sent through bulk mail/SMS nowadays. Student may update their E-Mail id/ Mobile Number instantly after logging into their account at www.icmai.in at request option.

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.

Send your Feedback to:
e-mail: studies.ebulletin@icmai.in
website: http://www.icmai.in

Message from

Directorate of Studies

Dear Students,

On the occasion of New Year 2022, we, from the Directorate of Studies of the Institute of Cost Accountants of India, wishing you all A Happy, Healthy & Prosperous New Year, 2022. We wish you a year filled with the blessings of God and may the new year also bring you peace, joy, and happiness.

On this New Year, may you change your direction, change your commitments, change your attitude, and bring about a change in your faith, your force, and your focus. May you live up to the promises you have made and may you create for you and your loved ones the happiest New Year ever.

The current coronavirus (COVID-19) pandemic is having a profound impact, not only on people's health, but also on how they learn, work and live. We request to all our students to be very careful because your carefulness may save others life, in the society as well.

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. If you sincerely follow those tips, we hope, you will be successful in your endeavour.

To celebrate 75 years of independence and commemorate it as **'Azadi Ka Amrut Mahotsav'**, India is celebrating, across the country and amid the coronavirus pandemic and also organizing various events. India's freedom fighters fought a long and hard struggle for the country's independence from the British and, for years, their words have inspired us. We hope that our students will also participate and pay their homage to the freedom fighters.

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

You can win!

The Institute is pleased to inform that the University Grants Commission (UGC) Ministry of Education, Govt. of India has announced that CMA qualification be Considered equivalent to PG Degree.

GOOD LUCK

Be Prepared and Get Success;

Few Snapshots

CMA P. Raju Iyer, President along with CMA Vijender Sharma, Vice President and CMA (Dr.) K Ch A V S N Murthy, Council Member of the Institute extending greetings to Shri Parmod Kumar Arora, Member (Actuary), Insurance Regulatory and Development Authority of India on 16th December, 2021.

CMA P. Raju Iyer, President along with CMA (Dr.) K Ch A V S N Murthy, Council Member of the Institute, CMA K Rajagopal, Chairman of SIRC, CMA S. Ramesh, Former Chairman of SIRC and CMA B.R. Prabhakar, Former Chairman of SIRC of the Institute extending greetings to Shri C.B. Ananthakrishnan, Director (Finance) & CFO of Hindustan Aeronautics Limited on 17th December, 2021.

CMA P. Raju Iyer, President of the Institute extending greetings to Shri Arjun Ram Meghwal, Hon'ble Union Minister of State for Culture and Parliamentary Affairs on 27th December, 2021 during a courtesy meeting and to extend an invitation of the Hon'ble MoS for the Skill Development Program to be organised by the Institute in the month of January 2022.

CMA Neeraj Joshi, Chairman, MAC, CMA Dr. D.P.Nandy, Sr Director, CMAChittaranjan Chattopadhyay, Chairman, BFSIB, Dr.Partha Ray, Director and Member Secretary, NIBM, Dr.Kaushik Mukherjee, Associate Professor, NIBM and Dr.Arindam Bandyopadhyay, Associate Professor (Finance)

CMA Chittaranjan Chattopadhyay, Chairman, BFSIB and CMA Debasish Mitra, Chairman, Board of Advanced Studies & Research of the Institute felicitating Dr. CKG Nair, Director, NISM alongwith other officials of the Institute and NISM.

THE INSTITUTE OF COST ACCOUNTANTS OF INDIA
(Statutory body under an Act of Parliament)
Headquarters: CMA Bhawan, 12, Sudder Street, Kolkata - 700 016
Phone: +91-33-2252-1031/34/35/1602/1492/1619/7373/7143
Delhi office: CMA Bhawan, 3, Institutional Area, Lodhi Road, New Delhi - 110 003
Phone: +91-11-2462-2156/2157/2158