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CMA Student E - Bulletin

FINAL

150 YEARS OF CELEBRATING THE MAHATMA

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(Statutory Body under an Act of Parliament)

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Behind every successful business decision, there is always a CMA

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Message from The Chairman

CMA Biswarup Basu

Vice President & Chairman,
Training & Education Facilities (T& EF) Committee

CMA BISWARUP BASU
Chairman, T & EF Committee
Directorate of Studies

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MESSAGE FROM THE CHAIRMAN

Dear Students,

Greetings,

"By Education, I mean an all -round drawing of the best in child and man in body, mind and spirit".

The December term of examination is approaching; stay positive, my friend and you can do this. No need to be nervous, no need to be scared, you're going to do well, you are prepared. You have silently studied for weeks, and now you will quietly take your exams. It's your success that's going to be loud and proud. You are strong, you are well prepared and you will succeed don't doubt yourself. All the sweat and all the tears are about to pay off in success and cheers. Invest in yourself. Study hard, and don't give up. I believe in you. Breathe in positivity. Exhale fear. Face that test with attitude. It's not about luck, but preparation. Eat, sleep, and study well. Keep the faith, and remember the goal. You can achieve this.

The Directorate of Studies (D.O.S.) has come out with revised work book in some papers where the amendments have taken place. As you are aware that study materials are continuously updated for incorporation of necessary amendments paper wise where those are extremely needed and also the up-dation is carried out in all the papers with the view of providing you the needed and relevant information. Answers to Mock Test Papers (MTPs) have been uploaded and please refer those for your steady professional development.

The Directorate of Studies is conducting live webinar sessions and those who are not been able to attend those sessions, please see the recorded versions for their knowledge up-dation. I am really thankful to all those academicians who are regularly updating your knowledge bank by extending their suggestions and input towards your all-round development. Please refer all those publications which will help in your preparation.

"I saw that bad handwriting should be regarded as a sign of an imperfect education" M.K. Gandhi

Testing is a celebration of knowledge. Go in there and show what you know. Good luck in your exams!

CMA Biswarup Basu

Vice President & Chairman, Training & Education Facilities and Placement Committee

Be a CMA, be a Proud Indian

150 YEARS OF CELEBRATING THE MAHATMA

"Behind every successful business decision there is always a CMA"

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150 YEARS OF CELEBRATING THE MAHATMA

KNOWLEDGE
Update

THE INSTITUTE OF COST ACCOUNTANTS OF INDIA

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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CORPORATE

LAWS & COMPLIANCE (CLC)

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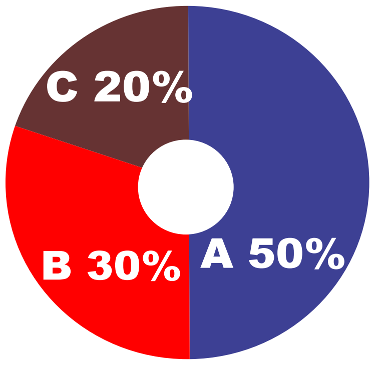
Your Preparation Quick Takes



Syllabus Structure
A Companies Act **50%**
B Other Corporate Laws **30%**
C Corporate Governance **20%**

Learning Objectives:

- Students will demonstrate their knowledge of the fundamental and technical concepts of accounting.
- Students will reveal critical-thinking and problem-solving skills.
- Students will exhibit the ability to recognize when change is appropriate, to adapt to change as it occurs, and to take the lead in creating change.
- Students will display a sense of responsibility and a capacity for the subject after learning.

The Companies Act, 2013
(Certain Aspects)

Company capital

Any business will have only two sources of capital. Own capital or loan capital, which is called equity capital and credit capital. The equity capital shall be permanently invested in the company whereas the loan has to be repaid after a certain period as per the terms of loan. However, there may conversion of loan into equity or equity into loan, if the company and the investor so decides.

The various types of instruments for raising capital is discussed below.

Shares and Debentures

Shares and debentures are the main source of long term source of capital. Companies Act does not consider working capital as capital and therefore the restrictions relating to treatment of capital do not apply to working capital.

Shares defined

A share is defined as unit of ownership that represents an equal proportion of a company's capital. It entitles its holder (the shareholder) to an equal claim on the company's profits and an equal obligation for the company's debts and losses.

Two major types of shares are (1) ordinary shares (common stock), which entitle the shareholder to share in the earnings of the company as and when they occur, and to vote at the company's general meetings of shareholders, and (2) **preference shares** (preferred stock) which entitle the shareholder to a fixed predetermined rate of dividend but generally do not have voting rights. The dividend is payable only when the Company makes adequate profits. This kind of shares is preferred for both payment of dividend and the payment of principal (redemption) on liquidation. Otherwise also preference shares have to be redeemed within 10 years of date of issue (20 years in case of infrastructure companies)

Types of Share Capital:

There are various terms used in connection with the share capital of the company. They are as follows:

Authorized / Registered / Nominal Capital-

This is the Maximum Capital which the company can raise. This is mentioned in the Memorandum of the Association of the Company. It is also called Registered Capital or Nominal Capital.Authorised capital may be increased by altering the Memorandum of Association.

Issued Capital-

This is the part of the Authorised Capital which is issued to the public for subscription i.e. any person to whom the invitation is made may subscribe for shares. Private limited companies can issue shares to its existing shareholders by way of rights issue or by way of giving them bonus shares or it can issue securities through private placements.The act of creating new issued shares is called issuance, allocation or allotment. After allotment, a subscriber becomes a shareholder. The number of issued shares is a subset of the total authorized shares.

Subscribed Capital-

The issued Capital may not be fully subscribed (applied for) by the investor/public. Subscribed Capital is that part of issued Capital for which applications are received from the public. In case applications are for more than the issued capital,we call it oversubscription. If it is less, it is called under subscription.

Paid-up Capital-

The part of subscribed capital whichhave been paid to the company by the investors i.e. the Company may require 50% of the value of shares while making subscriptions. In such case 50% of the value received by the company shall be the paid up capital.

For any company, paid-up capital is important as many provisions of the Act and Rules require various types f compliances based on paid-up capital.

Debentures

A debenture is a type of long term debt instrument which acknowledges debt. Debentures are backed only by the general creditworthiness and reputation of the issuer. Both corporations and Governments frequently issue this type of bond to secure capital. Debentures may be secured or unsecured.

Types of Debenture:

The major types of debentures are redeemable, irredeemable, convertible, non-convertible, fully, partly, secured, unsecured, fixed, floating rate, zero coupon, deep discount. Following are the various types of debentures vis-a-vis their basis of classification:

Redeemable and Irredeemable (Perpetual) Debentures

Redeemable debentures carry a specific date of redemption on the certificate. The company is legally bound to repay the principal amount to the debenture holders on that date. On the other hand, irredeemable debentures, also known as perpetual debentures, do not carry any date of redemption. This means that there is no specific time of redemption of these debentures. They are redeemed either on the liquidation of the company or when the company chooses to pay them off to reduce its liability by issues a due notice to the debenture holders beforehand.

Convertible and Non-Convertible Debentures

Convertible debenture holders have to convert their holdings into equity shares. The rate of conversion and the period after which the conversion will take effect are declared in the terms and conditions of the agreement of debentures at the time of issue. On the contrary, non-convertible debentures are simple debentures which will continue to be debentures till redemption. However, if option is given to the investor to convert or not to convert the debenture into shares, this kind of debenture is called optionally convertible debentures.

Fully and Partly Convertible Debentures

Convertible Debentures are further classified into two – Fully and Partly Convertible. Fully convertible debentures are completely converted into equity whereas the partly convertible debentures have two parts. Convertible part is converted into equity share as per agreed rate of exchange based on terms of issue. Non-convertible part remains as redeemable debenture which is repaid after the expiry of the agreed period.

Secured and Unsecured Debentures

When the debenture is secured by the charge on some asset or set of assets it is known as secured or mortgage debenture and when it is issued solely on the credibility of the issuer is known as the naked or unsecured debenture. In case of unsecured debenture, the debentureholder is like any other unsecured creditor. In case of secured debenture, there is a security created by the company on its assets. In case of issue of debenture on private placement basis, the security can be decided by the issuer company and the investor. Public issue of debentures have to be secured, if the maturity period is more than 18 months. In such case, a debenture trustee is appointed, to whom the security is mortgaged with a condition that if the company fails to repay interest or principal, the debenture trustee shall have right to sale off the property and satisfy the claims of debenture holders both interest and principal.

Fixed and Floating Rate Debentures

Fixed rate debentures have fixed interest rate over the life of the debentures. The floating rate debentures have the floating rate of interest which is dependent on some benchmark rate and goes on fluctuating depending on market conditions.

Zero Coupon Debentures

Zero coupon debentures do not carry any coupon rate (interest) or we can say that there is zero coupon rate. The debenture holder will not get any interest on these types of debentures. In such case a warranty is issued with a debenture which may have entitlement to get a share at discount. This compensates the interest foregone. However, zero coupon rate debentures may be issued at discount and are normally called "discounted bonds". If the maturity period is long it is called "deep discount bond".

Raising of Capital

A company may raise funds for different purposes depending on the time periods ranging from very short to fairly long duration. The total amount of financial needs of a company depends on the nature and size of the business. The scope of raising funds depends on the sources from which funds may be available. The business forms of sole proprietor and partnership have limited opportunities for raising funds. They can finance their business by the following means :-

- Investment of own savings
- Raising loans from friends and relatives
- Arranging advances from commercial banks
- Borrowing from finance companies

Companies can Raise Finance by a Number of Methods. To Raise Long-Term and Medium-Term Capital, they have the following options:-

Issue of Shares

It is the most important method. The liability of shareholders is limited to the face value of shares, and they are also easily transferable. A private company cannot invite the general public to subscribe for its share capital and its shares are also not freely transferable. But for public limited companies there are no such restrictions. There are two types of shares :-

- **Equity shares**- The rate of dividend on these shares depends on the profits available and the discretion of directors. Hence, there is no fixed burden on the company. Each share carries one vote.
- **Preference shares**- dividend is payable on these shares at a fixed rate and is payable only if there are profits. Hence, there is no compulsory burden on the company's finances. Such shares do not give voting rights.

Issue of Debentures

Debentures amount to loan and therefore should be within the borrowing powers of the directors. It is mostly issued to finance the long-term requirements of business and do not carry any voting rights.

Loans from Financial Institutions

Long-term and medium-term loans can be secured by companies from financial institutions like the Industrial Finance Corporation of India, Industrial Credit and Investment Corporation of India (ICICI) , State level Industrial Development Corporations, etc. These financial institutions grant loans for a maximum period of 25 years against approved schemes or projects. Loans agreed to be sanctioned must be covered by securities by way of mortgage of the company's property or assignment of stocks, shares, gold, etc.

Loans from Commercial Banks

Medium-term loans can be raised by companies from commercial banks against the security of properties and assets. Funds required for modernisation and renovation of assets can be borrowed from banks. This method of financing does not require any legal formality except that of creating a mortgage on the assets.

Public Deposits

Companies often raise funds by inviting their shareholders, employees and the general public to deposit their savings with the company. The Companies Act permits such deposits to be received for a period up to 3 years at a time. Public deposits can be raised by companies to meet their medium-term as well as short-term financial needs.

Sweat Equity Shares

"Sweat equity shares" means such equity shares, which are issued by a Company to its directors or employees at a discount or for consideration, other than cash, for providing their know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

Stock Option

A stock option is a privilege, sold by one party to another that gives the buyer the right, but not the obligation, to buy or sell a stock at an agreed-upon price within a certain period of time.

150 YEARS OF CELEBRATING THE MAHATMA

GROUP: 3, PAPER: 14

STRATEGIC FINANCIAL MANAGEMENT (SFM)

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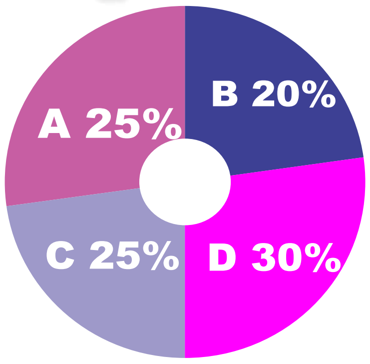
Your Preparation Quick Takes



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 advanced concepts of Financial Management
- develop and apply financial strategies

Strategic Financial Management

Study Note 1: Investment Decision, Project Planning and Control

Non-Discounted Cash Flow

1. **Accounting or Average Rate of Return Method:**

Accounting or Average Rate of Return (ARR) method measures the average annual net income out of the project (incremental income) as a percentage of the investment. After calculation of ARR it is compared with a predetermined or minimum required rate of return or cut-off rate set up by the firm, the project is accepted if the ARR is higher than the minimum desired ARR.

ARR can be calculated as follows: Accounting or Average Rate of Return (ARR)

$$= \frac{\textit{Average Annual Profit after Tax}}{\textit{Average Investment}} \times 100$$

Where, Average annual profit after tax =

Total profit after depreciation and tax of the whole life of the project /Project Life (in years)

Average Investment = (Initial Investment + Salvage Value)/ 2

Acceptance Rule: The project which gives the highest rate of return over the minimum required rate of return is acceptable.

Note: For further discussion refer to CMA Inter Study Notes.

2. **Payback Period Method:**

(a) Traditional Payback Period: This is a traditional or non-time value adjusted technique based on cash flow rather than profit. In other words, here numerical values of benefits i.e. cash flow are added over the years directly i.e. without discounting them.

- **Definition of Pay Back Period (PBP):**

Pay-back period is the period required by the firm to recover the original investment from the net cash flows of an investment project. It is basically an application of the 'break-even' concept to investment.

- **Determination of PBP:**

(a) When annual cash inflows are uniform:

PBP = Cost of Investment/Annual Cash flow.

e.g. A project requires an initial investment of Rs. 3,00,000. It yields annual cash inflow of Rs. 60,000 for 8 years. You are required to find out the pay-back period of the project.

Solution:

PBP = Cost of Investment/Annual Cash flow = 3,00,000/60,000 = 5 Years.

(b) When the annual cash inflows are not uniform:

Here PBP is determined at that point of time when cumulative cash flow becomes equal to the initial investment. Generally simple interpolation technique is used for this purpose.

e.g. A project requires an initial investment of Rs. 3,00,000. It yields cash inflow of Rs. 60,000, Rs. 50,000, Rs. 70,000, Rs. 75,000, Rs. 90,000, Rs. 60,000 for next 6 years. You are required to find out the pay-back period of the project.

Solution:

If cumulative cash flow is calculated, it can be identified that Rs. 3,00,000 is achieved in between 4th and 5th year. By simple interpolation the PBP can be calculated as follows:

$$\frac{PBP - 4}{5 - 4} = \frac{300000 - 255000}{345000 - 255000}$$

Or, PBP = 4.5 years.

- Decision Rules:

  1. Acceptance/ Rejection Decision:

  A project is accepted only if the PBP is lower than the target PBP set by the management.

  2. Mutually Exclusive Decision:

  The project with least PBP should be accepted.

- **Some Critical Issues:**

Though PBP method, as a traditional or non-time value adjusted method, is considered to be a better method than Accounting Rate of Return, in a number of situations it may mislead the decision maker.

For example, if the projects differ significantly in terms of the investment size, then it is very likely that the larger project will have higher PBP than the smaller one. In that case PBP may mislead while choosing between mutually exclusive projects. This dilemma is due to the size difference of the projects.

Similarly, if the projects differ in terms of life, then again accepting a project with lower PBP may not be a wise decision, if the other one is having a longer life after PBP where the profit potential is likely to be better.

In order to overcome the above limitations, traditional PBP method should not be used blindly but should be supported by some other criteria.

Two important extensions of traditional PBP are suggested therefore.

(b) Post Payback Profitability:

This variant of traditional PBP method is meant for providing an additional support in decision making in case the two projects differ significantly in terms of their life. This is because, traditional PBP only takes care of the risk involved. In such a case, a project with relatively higher PBP and hence rejected on such ground under traditional PBP method, may have more life left post payback and may earn higher overall profit to the organization.

Consider the following example.

Illustration 3:

Consider the following two projects and evaluate them to identify the better one based on (a) Traditional PBP Method and (b) Payback Profitability Method.

Particulars	Project A	Project B
Initial Investment (Rs.)	1,20,000	1,20,000
Cash Flow p.a. (Rs.)	20,000	24,000
Life of the project (in years)	10	6

Solution:

PBP = Initial Investment/Cash Flow p.a.

PBP(A) = 120000/20000 = 6 years

PBP (B) = 120000/24000 = 5 years

Thus, under Traditional PBP method project B with lower PBP is acceptable.

However, Post Payback Profitability = (Project Life – PBP) × Cash Flow p.a.

So, Post Payback Profitability (A) = (10 – 6) × 20,000 = Rs. 1,20,000

Post Payback Profitability (B) = (6 – 5) × 24,000 = Rs. 24,000

Thus, project A offers more overall profit. Hence project A is recommended.

Note: Here, traditional PBP method fails to consider the profitability aspect.

(c) Payback Reciprocal: In case of projects that significantly differ in terms of size i.e. initial investment, traditional PBP method is often found inadequate. Even Payback Profitability also fails to serve the purpose as higher investment normally brings higher profits. In such a scenario, Payback Reciprocal is considered to be very effective.

$$\text{Payback Reciprocal} = \frac{1}{PBP} = \frac{\textit{Post Payback Annual Profitability}}{\textit{Initial Investment}}$$

A project with higher Payback Reciprocal is always recommended.

Consider the following example.

Illustration 4:

Consider the following two projects and evaluate them to identify the better one based on (a) Traditional PBP Method and (b) Payback Profitability Method and (c) Payback Reciprocal Method.

Particulars	Project A	Project B
Initial Investment (Rs.)	60,000	1,20,000
Cash Flow p.a. (Rs.)	10,000	24,000
Life of the project (in years)	10	6

Solution:

PBP = Initial Investment/Cash Flow p.a.

PBP(A) = 60000/10000 = 6 years

PBP (B) = 120000/24000 = 5 years

Thus, under Traditional PBP method project B with lower PBP is acceptable.

However, Post Payback Profitability = (Project Life – PBP) × Cash Flow p.a.

So, Post Payback Profitability (A) = (10 – 6) × 10,000 = Rs. 40,000

Post Payback Profitability (B) = (6 – 5) × 24,000 = Rs. 24,000

Thus, project A offers more overall profit. Hence project A is recommended.

However, Payback Reciprocal (A) = 1/6 = 16.67%

Payback reciprocal (B) = 1/5 = 20%

Thus, considering the utilisation of fund Project B is acceptable.

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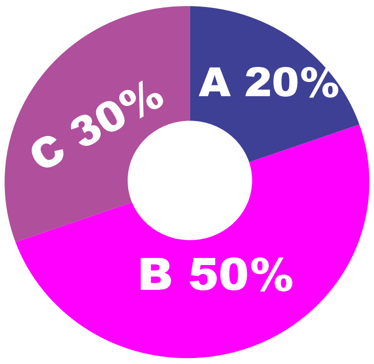
GROUP: 3, PAPER: 15

STRATEGIC COST MANAGEMENT-DECISIONMAKING (SCMD)

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?

Time – Cost Trade Off

Project Crashing

In addition to scheduling projects, a project manager is frequently confronted with the problem of having to reduce the scheduled completion time of a project to meet a deadline. In other words, the manager must finish the project sooner than indicated by the CPM or PERT network analysis.

Project crashing is a method for shortening project duration by reducing the time of one or more of the critical project activities to a time that is less than the normal activity time.

For example, project duration can be reduced by assigning more labour to project activities, often in the form of overtime, and by assigning more resources (material, equipment, etc.). However, additional labour and resources cost money and hence increase the overall project cost. Thus, the decision to reduce the project duration must be based on an analysis of the trade-off between time and cost.

Project crashing is a method for shortening project duration by reducing the time of one or more of the critical project activities to a time that is less than the normal activity time. This reduction in the normal activity times is referred to as crashing. Crashing is achieved by devoting more resources, measured in terms of money, to the activities to be crashed.

Cost of accelerating the completion of a project is known as 'Crash Cost'. The time taken by the activity when additional resources, overtime and other special measures are taken to speed up (crash) the activity is known as Crash Time.

Thus, project crashing shortens the project time by reducing critical activity times at a cost.

Normal Activity Time

There are three estimation times involved in PERT, viz.

Expected completion time is considered as the Normal Activity Time.

(i) **Optimistic Time Estimate (t_o)** : This is the fastest time an activity can be completed. The assumptions are that all the necessary resources are available and all the predecessor activities are completed as planned. This is the minimum time needed to complete the project.

(ii) **Most Likely Time Estimate (t_m)** : This is the most probable time in which an activity can be completed.

(iii) **Pessimistic Time Estimate (t_p)** : This is the maximum time required to complete an activity. In this case, it is assumed that many things may go wrong in relation to the activity. A lot of rework and resource unavailability are assumed when this estimation is derived.

The expected completion time (t_e) of a project is calculated by means of the formula:

$t_e = \{(t_o + 4t_m + t_p) / 6\}$

Where

t_o is the Optimistic Time Estimate

t_m is the Most Likely Time Estimate

t_p is the Pessimistic Time Estimate

Expected completion time is considered as the Normal Activity Time.

Cost Slope

The term 'cost-slope' is defined as the "increase in the cost of the activity per unit decrease in the time". Cost slope is computed as the ratio of 'difference between Crash Cost & Normal Cost' and 'difference between Normal Time & Crash Time'.

Mathematically stated,

Cost Slope = (Crash Cost – Normal Cost) / (Normal time – Crash time)

Problem:

As per Project Manager of Quick Construction Limited, you are involved in drawing a PERT network for laying the foundation of a new art museum. The relevant information for all the activities of this project is given in the following table:

Activity	Time estimates (in weeks)			Normal cost for expected duration	Crash cost	Immediate Predecessors
	T_0	T_m	t_p	(Rs.)	(Rs.)	
A	2	3	4	6,000	8,000	-
B	4	5	6	12,000	13,500	A
C	3	5	7	16,000	22,000	A
D	2	4	6	8,000	10,000	A
E	1	2	3	6,000	7,500	C,D
F	1	3	5	14,000	20,000	B,E

Required:

(i) Construct the PERT Network for the project and determine the critical path, expected duration and cost of the project.

(ii) The director of your company is not impressed by your PERT analysis. He draws your attention that the project must be completed by seven weeks and refers to the penalty clause in the agreement which provides for payment of penalty at the rate of Rs. 2,500 for every week or part there of exceeding seven weeks. Your Director also strongly believes that the time duration of various activities of the project can be crashed to their optimistic time estimates with the crashing costs mentioned in the above table. Determine the optimum duration of the project if your objective is to minimize the sum of the project execution cost and penalty cost.

Solution:

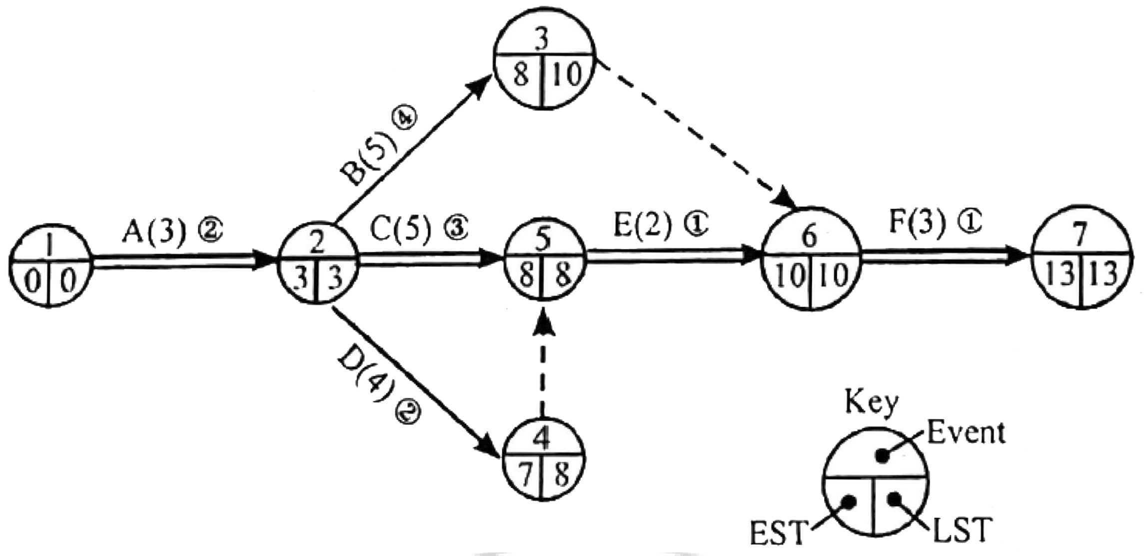
Part (i) Critical Path and the Expected Duration and Cost of the Project

We know that $t_e = \frac{a+4m+b}{6}$ or $\frac{t_0+4t_m+t_p}{6}$

Based on this formula, expected duration of each activity can be worked out as follows:

Activity	Time estimates (in weeks)			Workings $\frac{t_0+4t_m+t_p}{6}$	Expected Duration (in weeks)
	T_0	T_m	t_p		
A	2	3	4	(2 + 4*3 + 4) / 6	3
B	4	5	6	(4 + 4*5 + 6) / 6	5
C	3	5	7	(3 + 4*5 + 7) / 6	5
D	2	4	6	(2 + 4*4 + 6) / 6	4
E	1	2	3	(1 + 4*2 + 3) / 6	2
F	1	3	5	(1 + 4*3 + 5) / 6	3

The PERT network and the expected duration of each activity is given below:



Normal time of activities is written in brackets and crash time (T_0) in circle.

There are three paths as shown below:

Path 1: 1-2-3-6-7 = 3 + 5 + 3 = 11 weeks

Path 2: 1-2-5-6-7 = 3 + 5 + 2 + 3 = 13 weeks

Path 3: 1-2-4-5-6-7 = 3 + 4 + 2 + 3 = 12 weeks

The critical path happens to be 1-2-5-6-7 or A-C-E-F with project duration of 13 weeks.

However, the project has to be completed by seven weeks. Otherwise a penalty @Rs. 2,500 per weeks has to be paid. Therefore, the total project execution cost computes to:

Normal cost + Penalty cost = (Rs. 62,000) + (6 x Rs. 2,500) = Rs. 77,000

Part (ii) Crashing

Step 1 – The computations of cost slopes are given below:

Activity	(Normal Time – Crash Time) = Δ T (weeks)	(Crash Cost – Normal Cost) = Δ C (Rs.)	Cost Slope (Rs.) = (Δ C/ Δ T)	Ranking of Activities on CP
A : (1 – 2)	3 – 2 = 1	8,000 – 6,000 = 2,000	2,000	II
B : (2 – 3)	5 – 4 = 1	13,500 – 12,000 = 1,500	1,500	
C : (2 – 5)	5 – 3 = 2	22,000 – 16,000 = 6,000	3,000	III
D : (2 – 4)	4 – 2 = 2	10,000 – 8,000 = 2,000	1,000	
E : (5 – 6)	2 – 1 = 1	7,500 – 6,000 = 1,500	1,500	I
F : (6 – 7)	3 – 1 = 2	20,000 – 14,000 = 6,000	3,000	III

(a) As it is, there are the following three paths:

Path 1: 1-2-3-6-7 = 3 + 5 + 3 = 11 weeks

Path 2: 1-2-5-6-7 = 3 + 5 + 2 + 3 = 13 weeks

Path 3: 1-2-4-5-6-7 = 3 + 4 + 2 + 3 = 12 weeks

Path 2 is critical path and E (5-6) is the activity on critical path with minimum cost slope. If Activity E (5-6) is crashed by one week;

Project duration = 13 – 1 = 12 weeks

Decrease in cost = (-) 2,500 + 1,500 = (-) Rs. 1,000

Project Cost = 62,000 + (2,500 x 5) + 1,500 = Rs. 76,000

(b) After crashing of E by one week, the project duration for different paths is as follows:

Path 1 : 1-2-3-6-7 = 3 + 5 + 3 = 11 weeks

Path 2 : 1-2-5-6-7 = 3 + 5 + 1 + 3 = 12 weeks

Path 3 : 1-2-4-5-6-7 = 3 + 4 + 1 + 3 = 11 weeks

Still path 2 continues to be the critical path and next activity on critical path with the least cost slope is A (1-2). If Activity A (1-2) is crashed by one week, the project duration by different paths will be as follows:

Project duration = 12 – 1 = 11 weeks

Decrease in cost = (-) 2,500 + 2,000 = (-) Rs.500

Project Cost = 62,000 + (2,500 x 4) + (1,500 +2,000) = Rs. 75,500 or

76,000 - 2,500 + 2,000 = Rs. 75,500

(c)

(b) After crashing of A by one week, the project duration for different paths is as follows:

Path 1 : 1-2-3-6-7 = 2 + 5 + 3 = 10 weeks

Path 2 : 1-2-5-6-7 = 2 + 5 + 1 + 3 = 11 weeks

Path 3 : 1-2-4-5-6-7 = 2 + 4 + 1 + 3 = 10 weeks

Path 2 still continues to be critical path and the next activities with minimum cost slopes are C and F. Both are having cost slope of Rs. 3,000 each. If any of these activities is crashed, there will be net increase in cost by Rs. 500 (Rs. 3,000 – Rs. 2,500) per week. Since, objective is to minimise the sum of the project execution cost and the penalty cost, the decision would be not to crash activity C or F.

Hence

Optimum duration of the project = 11 weeks

Total minimum cost = Rs. 75,500

'Cost Benefit Analysis' is the crux of 'Time – Cost Trade Off'.

150 YEARS OF CELEBRATING THE MAHATMA

GROUP: 3, PAPER: 16

DIRECT TAX LAWS AND INTERNATIONAL TAXATION (DTI)

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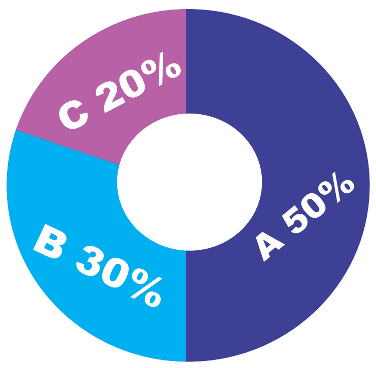
Your Preparation Quick Takes



Syllabus Structure

A Advanced Direct Tax Laws **50%**
B International Taxation **30%**
C Tax Practice and Procedures **20%**

Learning Objectives:

- To understand the concept of appeals before CIT – (Appeals)
- To know the provisions regarding appeal to Commissioner (Appeals).

Appeal before CIT (Appeals)

Appeal before CIT (Appeals)

One Law Dictionary defines 'appeal' as the act of asking a higher authority to change a decision of a lower authority. Right to appeal under Income-tax Law is a creation of statute and not an inherent right. Appeal can be filed only against orders listed in the Income Tax Act and not any order.

Initially, following course of action are available in the Income-tax Act:

Assessee	Department
Rectification u/s 154	Rectification u/s 154
Appeals to CIT (Appeals)	Revision u/s 263
Revision u/s 264	Reassessment u/s 147

Appellate Authorities in Income-tax Act

Appeal	Appellate authority	Against which order	Appellant
1st	Commissioner (Appeals)	Against specified order of the Assessing Officer	Assessee only
2nd	Income Tax Appellate Tribunal (ITAT)	Against the order of Commissioner (Appeals)	Assessee or the Commissioner (or Principal Commissioner) of Income tax.
3rd	High Court	Against the order of ITAT (the case must involve substantial question of law)	
Final	Supreme Court	Against the order of High Court	

Appeals to Commissioner of Income Tax (Appeals) [CIT (A)] [Sec. 246A to 250]

Aggrieved tax payer can file appeal before the Commissioner (Appeals) having, jurisdiction over the tax payer. Designation of the Commissioner (Appeals), with whom appeal is to be filed is also mentioned in the notice of demand issued by the Assessing Officer u/s156.

Provision regarding appeal to the Commissioner (Appeal) are enumerated below:

<table>
<tr>
<td>Appealable Orders</td>
<td colspan="2">
1. U/s 246A

Order passed by a Joint Commissioner u/s 115VP(3)(ii);
Order against the assessee, where the assessee denies his liability to be assessed under this Act;
Intimation u/s 143(1) or 143(1B) or 200A(1) or 206CB(1) or Order of assessment u/s 143(3) [Scrutiny assessment] [except an order passed in pursuance of directions of the Dispute Resolution Panel or an order referred to in sec. 144BA(12)] or u/s 144 [Best judgment assessment] in respect of income assessed or tax determined or loss computed or residential status;
Order of assessment, reassessment or recomputation u/s 147 [(except an order passed in pursuance of directions of the Dispute Resolution Panel or an order referred to in sec. 144BA(12)], 150 & 153A [except an order passed in pursuance of directions of the Dispute Resolution Panel or an order referred to in sec. 144BA(12)];
Order u/s 154 (Rectification of Mistake) or u/s 155 (other amendments) having the effect of enhancing the assessment or reducing a refund or an order refusing to allow the claim made by the assessee [except where it is in respect of an order referred to in sec. 144BA(12)]
Order of assessment or reassessment u/s 92CD(3)
Order u/s 163 treating assessee as an agent of a non-resident;
Order u/s 170 relating to assessment on succession;
Order u/s 171 refusing to recognize partition of an HUF;
Order u/s 201 or 206C(6A) for default of provisions of TDS/TCS;
Order u/s 237 relating to refunds;
Order relating to Penalty;
Order imposing penalty under chapter XXI;
An order of penalty imposed under chapter XXI or an order of imposing or enhancing penalty u/s 275(1A)
Any order made by an Assessing Officer other than a Joint Commissioner, as the Board may direct.

2. U/s 248
Where under an agreement or other arrangement –

the tax deductible u/s 195 on any income (other than interest) is to be borne by the person by whom the income is payable; &
such person having paid such tax to the credit of the Central Government, claims that no tax was required to be deducted on such income,

he may appeal to the Commissioner (Appeals) for a declaration that no tax was deductible on such income
Notes:
a) Even when reassessment proceedings have been initiated u/s 147, an appeal can still be filed against the original assessment order passed u/s 143(3)
b) Assessee has the right to appeal against an order of the Assessing Officer which is passed while giving effect to the decision of the appellate authority.
</td>
</tr>
<tr>
<td rowspan="5">Time limit for filing appeal</td>
<td colspan="2">Appeal should be filed within 30 days from -</td>
</tr>
<tr>
<td>Where the appeal is u/s 248</td>
<td>The date of payment of the tax</td>
</tr>
<tr>
<td>Where the appeal relates to any assessment or penalty</td>
<td>The date of service of notice of demand relating to the assessment or penalty</td>
</tr>
<tr>
<td>In any other case</td>
<td>The date on which intimation of the order, sought to be appealed against, is served.</td>
</tr>
<tr>
<td colspan="2">
Period to be excluded [Sec.268]
While calculating the above time limit, following period shall be excluded -
a) The day on which order complained was served; and
b) Time required for obtaining a copy of the order, where a copy of the order was not furnished with notice of demand.
c) Where an application has been made u/s 270AA (seeking immunity from penalty and prosecution), the period beginning from the date on which the application is made, to the date on which the order rejecting the application is served on the assessee
</td>
</tr>
</table>

Delay in filing appeal	The Commissioner (Appeals) may admit belated application on sufficient cause being shown. **Note:** It is statutory obligation of the appellate authority (where an application for condonation is filed) to consider whether sufficient cause was shown by the appellant
Form of appeal	Form 35 (Mode of filing depends i.e., electronically or in paper form, on mode of filing return of income of the assessee)
Documents to be submitted	• Order against which appeal is made • Statement of facts • Grounds of appeal • Notice of demand (in Original) • Challan
Verification of Form	Form & grounds of appeal must be verified by the person authorised to verify the return of income u/s 140
Payment of tax before filing of appeal	**If a return has been filed –** Tax as per the return should be paid. **If no return has been filed –** The assessee should pay an amount equal to the advance tax which was payable by him. However, CIT(A) may, for any good and sufficient reason (recorded in writing), accept the appeal without payment of such advance tax. **Power of Assessing Officer:** As per sec. 220(6), where an assessee has presented an appeal u/s 246A, Assessing Officer may treat the assessee as not being in default in respect of the amount in dispute in the appeal. It may be applied - • at the discretion of the Assessing Officer; • subject to such conditions as Assessing Officer may think fit to impose; • even though the time for payment has expired; • as long as such appeal remains undisposed of. Where assessee has not made an application u/s 220(6) or his application u/s 220(6) has been rejected, he can approach the appellate authority for stay order against collection
Fee	Where assessed income as computed by the Assessing Officer is - • Up to ₹ 1,00,000 — - ₹ 250 • Exceeds ₹ 1,00,000 but does not exceed ₹ 2,00,000 — - ₹ 500 • Exceeds ₹ 2,00,000 — - ₹ 1,000 Where the subject matter of appeal is not covered in above cases — - ₹ 250
Procedure	1. **Fixation of Day & Place:** The Commissioner (Appeals) shall fix a day and place for the hearing of the appeal, and shall give notice of the same to the appellant and to the Assessing Officer against whose order the appeal is preferred. 2. **Hearing:** The appellant (either in person or by an authorised representative) and the Assessing Officer (either in person or by an authorised representative) shall have the right to be heard at the hearing of the appeal. **Taxpoint:** Where the assessee does not insist on a personal hearing the appeal may be decided on the basis of written submission made by him. [Letter No. 277/7/84 of November, 1985] 3. **Adjournment:** The Commissioner (Appeals) shall have the power to adjourn the hearing of the appeal from time to time. 4. **Inquiry:** The Commissioner (Appeals) may, before disposing of any appeal, make such further inquiry as he thinks fit, or may direct the Assessing Officer to make further inquiry and report the result of the same to the Commissioner (Appeals). 5. **Order:** Commissioner (Appeals) must dispose of the appeal by passing an order which shall - • be in writing; • mention the points for determination; • mention the decision thereon; and • mention the reason for the decision.

<table>
<tr><td></td><td colspan="2">6. Communication of Order: The Commissioner (Appeals) shall communicate the order passed by him to the assessee and to the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner.
Note: If during pendency of an appeal, provision of any law has changed with retrospective effect, then such changed law shall be applicable on such appeal too. Law amended retrospectively would be a good law for applicability during the pendency of the appeal</td></tr>
<tr><td>New grounds during hearing</td><td colspan="2">The Commissioner (Appeals) may, at the hearing of an appeal, allow the appellant to go into any ground of appeal not specified in the 'grounds of appeal', if he is satisfied that the omission of that ground from the Form of appeal was not wilful or unreasonable.</td></tr>
<tr><td>Time limit for disposal of appeal</td><td colspan="2">Within one year from the end of financial year in which appeal is filed (if possible).</td></tr>
<tr><td>Production of additional evidence</td><td colspan="2">Appellate authority has the power to accept additional evidence (after recording reason for its admission in writing) and may make further enquiry at his discretion before disposing of the appeal
In the following circumstances additional evidence shall be admitted by the Commissioner (Appeals):
a) Where the Assessing Officer has refused to admit evidence which ought to have been admitted; or
b) Where appellant was prevented by sufficient cause from producing before the Assessing Officer any evidence, which is related to any ground of appeal; or
c) Where the appellant was prevented by sufficient cause from producing the evidence, which he was called upon to produce by the Assessing Officer; or
d) Where the Assessing Officer has made an order (appealed against) without giving sufficient opportunity to the appellant to produce evidence relevant to any ground of appeal.
<u>Taxpoint</u>: Before taking into account the additional evidence filed, Commissioner (Appeals) is to provide reasonable opportunity to the Assessing Officer for examining the additional evidence or the witness as well as to produce evidences to rebut additional evidences filed by the tax payer.</td></tr>
<tr><td rowspan="5">Powers of Commissioner (Appeals) u/s 251</td><td>1. Against an order of assessment</td><td>To confirm, reduce, enhance or annul the assessment</td></tr>
<tr><td>2. Against an order imposing a penalty</td><td>To confirm or cancel such order or vary it so as either to enhance or to reduce the penalty;</td></tr>
<tr><td>3. Against the order of assessment in respect of which the proceeding before the Settlement Commission abates u/s 245HA</td><td>To confirm, reduce, enhance or annul the assessment after taking into consideration all the material and other information produced by the assessee before, or the results of the inquiry held or evidence recorded by, the Settlement Commission, in the course of the proceeding before it and such other material as may be brought on his record</td></tr>
<tr><td>4. Relating to any other case</td><td>To pass such orders as he thinks fit.</td></tr>
<tr><td colspan="2">Notes:
1. The Commissioner (Appeals) may consider and decide any matter arising out of the proceedings in which the order appealed against was passed, notwithstanding that such matter was not raised before the Commissioner (Appeals) by the appellant.
2. Commissioner (Appeals) shall not enhance an assessment or a penalty or reduce the amount of refund unless the appellant has had a reasonable opportunity of showing cause against such enhancement or reduction.
3. An assessment order, which is void ab initio cannot become a valid order simply by virtue of the fact that it has been confirmed by an appellate authority.</td></tr>
<tr><td>Withdrawal of appeal</td><td colspan="2">Appeal once filed cannot be withdrawn.</td></tr>
</table>

GROUP: 4, PAPER: 17

CORPORATE FINANCIAL REPORTING (CFR)

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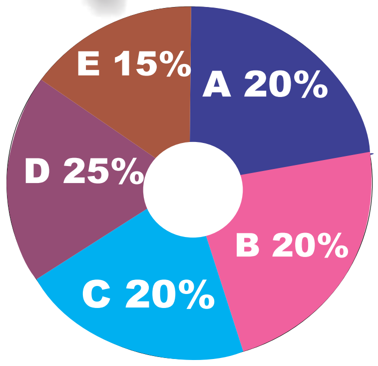
Your Preparation Quick Takes



Syllabus Structure

A GAAP and Accounting Standards **20%**
B Accounting if Business Cominations & 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

Business Combination and Consolidated Balance Sheet: Recapitulation

In the preceding issues discussion was made on accounting for business combination and on preparation of consolidated balance sheet and separate balance sheet. In this issue we shall recapitulate.

When a company purchases less than 20% shares of another company the transaction is recorded in the books of investor company as —

Investment A/c Dr.
To, Bank/Equity A/c

Investment A/c will appear in the **Individual** Balance sheet of Investor company.

When a company purchases 20% or more shares of another company, having significant influence in the investee (called Associate), the transaction is recorded in the books of investor company as:

Investment A/c Dr.
To, Bank/Equity A/c

Investment A/c will appear in the **Separate** and also in the **Consolidated** Balance sheet of investor company. In the subsequent years in Separate Balance sheet Investment A/c will be carried at cost or as per Ind AS 109.

However, in consolidated accounts, Investment A/c shall be valued under **Equity Method**. If in subsequent years Investee company's net assets change (assume, increase) by Profit or loss and by other comprehensive income, following journal entry shall be passed in the consolidated accounts of the investor company:

Investment A/c Dr. (share of investor in change of net assets of investee)
To, P/L A/c (share of P/L)
To, OCI A/c (share of OCI)

Thus, in consolidated balance sheet Investment A/c shall appear at cost plus share of investor company in change of net assets of the investee and Other Equity will increase by share of P/L and OCI of the investee.

This is the required accounting for investment in Associates as per Ind AS 28 and 27. The same accounting is done for investment in Joint Venture, where the investor has joint control.

But when by purchase of shares investment company acquires control of investee company (NOT Joint control), the investee becomes subsidiary and investor is parent. For such transaction, at the acquisition date accounting shall be made in the consolidated accounts of the parent and also in the separate accounts of parent.

In the separate accounts the following entry shall be made:

Investment A/c Dr.
To, Bank/Equity A/c

In the subsequent years in Separate Balance Sheet Investment A/c will be carried at cost or as per Ind AS 109.
However in consolidated accounts following entry will be passed under acquisition method of Ind AS 103:

Assets (of subsidiary identified at Fair Value) Dr.

Goodwill (balancing figure) Dr.

To, Consideration

To, Liabilities (of subsidiary identified at Fair Value)

To, Previously held Interest (at fair value)

To, Non-Controlling Interest (at fair value or at proportionate net asset value)

To, Gain on bargain purchase (balancing figure)

Thus, at acquisition, the assets and liabilities of parent at carrying amount are combined with the fair value of assets and liabilities of subsidiary for preparation of consolidated balance sheet. Goodwill is shown under non-current assets or Gain on bargain purchase is shown under (consolidated) Other Equity. Non-Controlling Interest is also shown below Other Equity.

If subsequently, parent purchases additional shares in subsidiary, NCI is reduced proportionately to its carrying amount and the following entry is passed:

NCI (at proportionate carrying amount) Dr.

To, Bank/Equity

Difference, if any, between proportionate carrying amount of NCI and consideration for additional stake is debited or credited to Other Equity.

If subsequently some shares of subsidiary is sold retaining control of parent:

Bank A/c Dr.

To, NCI (at proportionate carrying amount)

Difference, if any, between proportionate carrying amount of NCI and sale value of shares is debited or credited to Other Equity.

Thus we see that preparation of consolidated balance sheet under Ind AS 110 at the acquisition date is simply incorporating the entries of business combination with the balance sheet items of parent. However, for subsequent periods, post acquisition changes (say, increase) in carrying amount of net assets of subsidiary (same as change in Other Equity, equity share capital is assumed to remain unchanged) have to be taken into consideration. In consolidated accounts change in net assets of subsidiary (say, increase) is given effect (to consolidated assets and liabilities) and Other Equity increases by parent's share and NCI increases by NCI share.

Thus, we see that post acquisition change in other equity of subsidiary is divided to parent and NCI in the ratio of their respective shares. Consolidated other equity is the sum total of parent's other equity and share of parent in subsidiary's post acquisition change in other equity. Goodwill is measured at acquisition date under Ind AS 103. Even if subsidiary pays dividend subsequently (whether out of pre acquisition or post acquisition profits) there will be no change in Goodwill. NCI in subsequent consolidated balance sheet is the sum total of NCI at acquisition and NCI's share in post acquisition change in other equity of subsidiary. However on the reporting date any dividend (whether out of pre acquisition or post acquisition profits) payable by subsidiary shall, to the extent of NCI's share, be subtracted from NCI to be shown as a separate liability.

Let us take an illustrative problem.

Illustration:

Company P Ltd. acquires 80% shares of company S Ltd. on 01.04.17 by issue of equity shares of ₹10 each at a premium of ₹30. The financial data of the companies at 31.03.2017 are stated below. Non-Controlling Interest is valued at fair value. (All amounts are in ₹ Lakhs).

	On 31.03.17			On 31.03.2018	
	P	S	FV of S	P	S
PPE	720	480	700	800	560
Investment in S				640	
CA	450	350	300	500	360
Equity	500	300		1240	360
Noncurrent Liability	350	300	310	320	320
Current Liability	320	230	200	380	240

Pass entries for business combination under acquisition method and show consolidated and separate balance sheet abstract on 31.03.17 and on 31.03.18.

Solution:

(All amounts are in ₹ Lakhs)

WN 1: Purchase consideration is 640 (paid up 10; premium 30; Equity share capital 160 and Security Premium 480)

WN 2: Fair Value of Net Identified Assets

	FV of S
PPE	700
CA	300
Noncurrent Liability	(310)
Current Liability	(200)
Net Assets	490

WN 3: NCI at fair value = 20%/80% × 640 = 160

WN 4: Goodwill = Consideration + NCI – Net Assets = 640 + 160 – 490 = 310

- Journal entries for business combination

Particulars		Debit (₹)	Credit (₹)
PPE	Dr.	700	
CA	Dr.	300	
Goodwill (WN 4)	Dr.	310	
To Non Current Liability			310
To Current Liability			200
To Purchase Consideration			640
To NCI (WN 3)			160
Purchase Consideration	Dr.	640	
To Equity Share Capital			160
To Security Premium			480

- Consolidated Balance Sheet (abstract) of P and S at 01.04.17

		Consolidated	Separate
PPE	720+700	1420	720
Goodwill		310	
Investment			640
CA	450+300	750	450
Total Assets		2480	1810
Equity	500+640	1140	1140
NCI		160	-
Noncurrent Liability	350+310	660	350
Current Liability	320+200	520	320
Total of Equity and Liability		2480	1810

WN 5: Other Equity of S

Balance on 31.03.18		360		
Less: Balance on 31.03.17		300		
Increase			60	
Revaluation loss of Current assets	50			
Revaluation profit of Current liabilities	30			
Net Loss	20			
Revaluation net loss reverted			20	
Post acquisition change in other equity				80
P's share				64
NCI				16

WN 6: Consolidated equity = 1240 + 64 = 1304

WN 7: NCI on 31.03.18 = 160 +16 = 176

- Consolidated Balance Sheet (abstract) of P and S at 31.03.18

		Consolidated	Separate
PPE	800+560+220 (Rev)	1580	800
Goodwill		310	
Investment			640
CA	500+360	860	500
Total Assets		2750	1940
Equity		1304	1240
NCI		176	
Noncurrent Liability	320+320 + 10 (Rev)	650	320
Current Liability	380+240	620	380
Total of Equity and Liability		2750	1940

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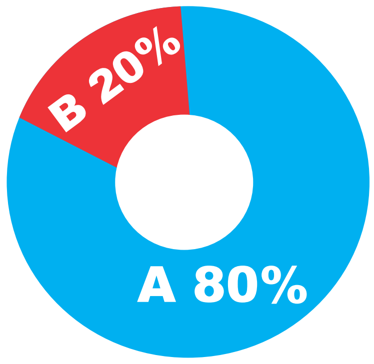
GROUP: 4, PAPER: 18

INDIRECT TAX LAWS & PRACTICE (ITP)

Your Preparation Quick Takes



Syllabus Structure

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

B Tax Practice and Procedures **20%**

Learning Objectives:

- Pre GST era tax structure and main benefit of introducing GST Act.
- Reason to incorporate ITC in GST system
- Input Tax Credit mechanism
- Manner of taking ITC
- CBIC latest notification for utilisation of ITC
- CBIC latest notification to restrict on claiming of ITC without invoice
- Few Central Tax Notification
- Need of reconciliation with vendors or suppliers
- ITC claim for who become first time eligible

Input Tax Credit

The much awaited Goods and Service Tax Act came into effect from 1st July,2017. Before that Indirect Taxes were subject to both Centre and State. The Service Tax were exclusively under Central Government. As for the taxes levied on goods, Central Government collected taxes up to the manufacture stage. While the state governments collected tax on both intra state as well as inter-state sales.

Indirect Taxes like Central Excise, Customs and Service Tax were under the ambit of Central Government where as Value Added Tax (VAT) and Central Sales Tax (CST) were major sources of tax for the State Government along with Octroi, Entertainment Tax etc. whereever were applicable.

In order to avoid the impact of tax on tax i.e. cascading effect of taxes, where there was no scope to set off taxes paid on input against output tax payable on goods or services or both, moreover taxes paid by tax payer in one state were not available for set off against taxes payable in other state.

Input Tax Credit (ITC) mechanism was incorporated in GST system mainly to :

1. Consolidate various indirect taxes levied into a single tax and
2. Scope of setting of taxes i.e. to claim Input Tax Credit.

The word 'Input' depicts that any goods other than capital goods used or intended to be used by any one in the course of business, and the required taxes paid on such inward supply of inputs, capital and services can be consider as input taxes. Input taxes include the following –

(a) Integrated GST,

(b) Central GST,

(c) State GST or Union Territory GST.

In broader scene the Input Tax Credit means deduction of the tax paid on inputs from the tax payable on the final output by a registered taxable person i.e. as receiver of inputs or input services, deduction can be made on the amount of tax paid on inputs or input services against the tax on output.

Manner and taking of Input Credit

Every registered taxable person shall, subject to such conditions and restrictions as may be stated and in the process specified in section 49 of CGST Act.

CGST Circular No. 98/17/2019 was issued on 23 April 2019 has clarified the order of ITC utilisation for each tax head, which is appended below -

Circular No – 98/17/2019-GST

F. No. CBEC – 20/16/04/2018 – GST

Government of India

Ministry of Finance

Department of Revenue

Central Board of Indirect Taxes and Customs

GST Policy Wing

****

New Delhi, Dated the 23rd April 2019

To

The Principal Chief Commissioners / Chief Commissioners / Principal Commissioners / Commissioners of Central Tax (All)

The Principal Director Generals / Director Generals (All)

Madam/Sir,

Subject: Clarification in respect of utilization of input tax credit under GST – Reg.

1. Section 49 was amended and Section 49A and Section 49B were inserted vide Central Goods and Services Tax (Amendment) Act, 2018 [hereinafter referred to as the CGST (Amendment) Act]. The amended provisions came into effect from 1st February 2019.
2. Various representations have been received from the trade and industry regarding challenges being faced by taxpayers due to bringing into force of section 49A of the Central Goods and Services Tax Act, 2017 (hereinafter referred to as the CGST Act). The issue has arisen on account of order of utilization of input tax credit of integrated tax in a particular order, resulting in accumulation of input tax credit for one kind of tax (say State tax) in electronic credit ledger and discharge of liability for the other kind of tax (say Central tax) through electronic cash ledger in certain scenarios. Accordingly, rule 88A was inserted in the Central Goods and Services Tax Rules, 2017 (hereinafter referred to as the CGST Rules) in exercise of the powers under Section 49B of the CGST Act vide notification No. 16/2019- Central Tax, dated 29th March, 2019. In order to ensure uniformity in the implementation of the provisions of the law, the Board, in exercise of its powers conferred by section 168 (1) of the CGST Act, hereby clarifies the issues raised as below.
3. The newly inserted Section 49A of the CGST Act provides that the input tax credit of Integrated tax has to be utilized completely before input tax credit of Central tax / State tax can be utilized for discharge of any tax liability. Further, as per the provisions of section 49 of the CGST Act, credit of Integrated tax has to be utilized first for payment of Integrated tax, then Central tax and then State tax in that order mandatorily. This led to a situation, in certain cases, where a taxpayer has to discharge his tax liability on account of one type of tax (say State tax) through electronic cash ledger, while the input tax credit on account of other type of tax (say Central tax) remains un-utilized in electronic credit ledger.
4. The newly inserted rule 88A in the CGST Rules allows utilization of input tax credit of Integrated tax towards the payment of Central tax and State tax, or as the case may be, Union territory tax, in any order subject to the condition that the entire input tax credit on account of Integrated tax is completely exhausted first before the input tax credit on account of Central tax or State / Union territory tax can be utilized. It is clarified that after the insertion of the said rule, the order of utilization of input tax credit will be as per the order (of numerals) given below:

<table>
<tr><th>Input tax Credit on account of</th><th>Output liability on account of Integrated tax</th><th>Output liability on account of Central tax</th><th>Output liability on account of State tax / Union Territory tax</th></tr>
<tr><td>Integrated tax</td><td>(I)</td><td colspan="2">(II) – In any order and in any proportion</td></tr>
<tr><td colspan="4">(III) Input tax Credit on account of Integrated tax to be completely exhausted mandatorily</td></tr>
<tr><td>Central tax</td><td>(V)</td><td>(IV)</td><td>Not permitted</td></tr>
<tr><td>State tax / Union Territory tax</td><td>(VII)</td><td>Not permitted</td><td>(VI)</td></tr>
</table>

5. The following illustration would further amplify the impact of newly inserted rule 88A of the CGST Rules:

Illustration:

Amount of Input tax Credit available and output liability under different tax heads

Head	Output Liability	Input tax Credit
Integrated tax	1,000	1,300
Central tax	300	200
State tax / Union Territory tax	300	200
Total	1,600	1,700

Option 1:

Input tax Credit on account of	Discharge of output liability on account of Integrated tax	Discharge of output liability on account of Central tax	Discharge of output liability on account of State tax / Union Territory tax	Balance of Input Tax Credit
Integrated tax	1000	200	100	0
Input tax Credit on account of Integrated tax has been completely exhausted				
Central tax	0	100	-	100
State tax / Union territory tax	0	-	200	0
Total	1000	300	300	100

Option 2:

Input tax Credit on account of	Discharge of output liability on account of Integrated tax	Discharge of output liability on account of Central tax	Discharge of output liability on account of State tax / Union Territory tax	Balance of Input Tax Credit
Integrated tax	1,000	100	200	0
Input tax Credit on account of Integrated tax has been completely exhausted				
Central tax	0	200	-	0
State tax / Union territory tax	0	-	100	100
Total	1,000	300	300	100

6. Presently, the common portal supports the order of utilization of input tax credit in accordance with the provisions before implementation of the provisions of the CGST (Amendment) Act i.e. pre-insertion of Section 49A and Section 49B of the CGST Act. Therefore, till the new order of utilization as per newly inserted Rule 88A of the CGST Rules is implemented on the common portal, taxpayers may continue to utilize their input tax credit as per the functionality available on the common portal.

7. It is requested that suitable trade notices may be issued to publicize the contents of this circular.

8. Difficulty, if any, in the implementation of this Circular may be brought to the notice of the Board. Hindi version would follow.

(Upender Gupta)
Principal Commissioner (GST)

The registered person entitled to take credit of input tax charged on any supply of goods or services or both made to him which are utilised or intended to be utilised in the course of furtherance of his business and the said amount shall be credited to the electronic credit ledger of such person – section 16(1) of CGST Act.

GST Input tax credit without invoice can be claimed maximum at 20%.

To check the revenue leakage, the government has already notified to restrict the claiming of input tax credit under the Goods and Services Tax to 20% of the eligible amount for an entity if its supplier has not uploaded relevant invoices detailing the payments made.

From 9 October, 2019 CBIC notified that only 20% of ITC available in GSTR-2A can be claimed as provisional ITC in GSTR-3B. It means the amount of ITC reported in GSTR-3B from 9 October, 2019 will be a total of Actual ITC in GSTR-2A and provisional ITC being 20% of actual ITC in GSTR-2A. Hence, matching purchase register or expense ledger with GSTR-2A becomes very important.

Some of the important Central Notification came into effect after 1st April.2019 given below –

Central Tax Notifications

Notification Number	Date	Subject	Description
49/2019	09/10/19	Seeks to carry out changes in the CGST Rules, 2017	The Central Government makes the following rules to amend the Central Goods and Services Tax Rules, 2017, in respect of issuing of invoices, furnishing of returns, claiming of input tax credit and other matters.
47/2019	09/10/19	Annual return under GST to be made optional for taxpayers whose aggregate turnover in a financial year does not exceed ₹ 2 crore for FY 2017-18 and 2018-19	The Central Government has notified that the annual return under GST for taxpayers having an aggregate turnover which does not exceed ₹ 2 crore shall be made optional for FY 2017-18 and FY 2018-19
46/2019	09/10/19	The due date for furnishing FORM GSTR-1 for persons having aggregate turnover of more than ₹1.5 crore for the quarters of October, 2019 to March, 2020 has been notified	The Central Government has notified that the return in FORM GSTR-1 for the months of October, 2019 to March, 2020, by registered persons having aggregate turnover of more than 1.5 crore rupees in the preceding financial year or the current financial year, shall be furnished electronically through the common portal, on or before the eleventh day of the month succeeding such month.
44/2019	09/10/19	The due date for furnishing FORM GSTR-3B for the months of October, 2019 to March, 2020 have been notified	The Central Government has notified that the return in FORM GSTR-3B for the months of October, 2019 to March, 2020 shall be furnished electronically through the common portal, on or before the twentieth day of the month succeeding such month.
43/2019	30/9/19	Manufacturers of Aerated Waters are excluded from the Composition Scheme	The Central Government has notified that manufacturers of aerated waters shall not be eligible to opt for Composition Levy from 1st October, 2019.
42/2019	24/9/19	The provisions of rules 10, 11, 12 and 26 of the CGST (Fourth Amendment) Rules, 2019 comes into force from 24th September 2019	The Central Government has notified 24th September 2019 as the date from which the provisions of rules 10, 11, 12 and 26 of the Central Goods and Services Tax (Fourth Amendment) Rules shall come into force.
41/2019	31/8/19	Waiver of late fees in certain cases for the month of July, 2019 for FORM GSTR-1 and GSTR-6 provided the said returns are furnished by 20th September 2019	The Central Government notifies the waiver of late fees for certain registered persons whose principal place of business falls in the districts/state mentioned in the notification, having an aggregate turnover of more than ₹1.5 crore in the preceding FY or current FY, and have filed GSTR-1 or GSTR-6 for July, 2019 on or before 20th September 2019.
38/2019	31/8/19	Waiver from filing FORM ITC-04 for F.Y. 2017-18 & 2018-19	Filing of FORM ITC-04 for the period July 2017 to March 2019 shall be waived for such persons who were required to furnish the form, provided the said persons shall furnish such details as prescribed in the notification for the period July, 2017 to March, 2019 in serial number 4 of FORM ITC-04 for the quarter April-June, 2019.
33/2019	18/7/19	Changes to the CGST Rules- Central Goods and Services Tax (Fifth Amendment) Rules, 2019	Following changes are made in the CGST rules: 1. The GST registration rules are now amended to include reference to TDS deduction provision Section 52 of CGST Act. 2. e-ticketing introduced for exhibition of cinematograph films in multiplex screens. 3. A new rule for Surrender of enrolment of goods and services tax practitioner. 4. A new rule is introduced for Application for unblocking of the facility for generation of E-Way Bill and order thereof 5. The declaration statement in Statement 5B while applying for GST refund for deemed exports is changed.

31/2019	28/06/19	Changes to the CGST Rules 2017- Central Goods and Services Tax (Fourth Amendment) Rules, 2019	1. A time limit has been specified for new registrants under GST to furnish bank account details on GST portal earlier of due date of filing first GST return applicable to them or within 45 days from the grant of GST registration. 2. Value of supply in cases where Kerala Flood cess is applicable. 3. There are changes to Rule 66 and 67 of CGST Rules Form and manner of submitting TDS and TCS returns. 4. Changes have been made to Rule 87 governing electronic cash ledger(ECL)- Introduction of PMT-09 for transfer of cash from one ECL to another. 5. New rule for GST refund has been prescribed covering Refund of taxes to the retail outlets established in departure area of an international Airport. 6. A new format for GSTR-4 is notified to be filed by 30th April for a given financial year. 7. A new format for DRC-03 is notified.
30/2019	28/06/19	Exemption for non-resident OIDAR service providers from submitting GSTR-9 & GSTR-9C.	The persons who are non-residents and are providing OIDAR service in India to unregistered persons have been exempted from submitting GSTR-9 and GSTR-9C.
21/2019	23/04/19	Notification of procedure for quarterly tax payment and annual filing of return for service providers availing the benefit of Notification No. 02/2019– Central Tax (Rate), dated the 7th March, 2019	CMP-08 (filed quarterly) and new version of GSTR-4(filed annually) will apply to service providers opting into composition scheme notified for them under Notification No. 02/2019– Central Tax (Rate), dated the 7th March, 2019.
20/2019	23/04/19	Seeks to make Third amendment, 2019 to the CGST Rules.	1. Filing of GST returns in case of revocation of cancellation of the GST registration. 2. The present quarterly return in GSTR-4 replaced by a statemnet in CMP-08 and annual return GSTR-4. 3. Option included in REG-01 for service providers to opt into composition scheme.

Reconciliation of Purchase register and Expenses Register

A registered taxable person before mentioning the Input Tax credit figures in GSTR – 3B,should reconcile the purchase register and expenses register for the period with GSTR- 2A of the same period. He should continuously communicate and tally the figures with his vendors or supplier before filing GSTR- 3B.

Instead of claiming self assessed ITC on the basis of Invoice copies the registered taxable person now required to follow up regularly with their vendors to upload their invoices or debit notes in every month to avoid the mismatch.

Input Tax Credit by registered taxable person first time becomes eligible

Taxable registered person in some cases become liable to pay GST at a later stage and can avail Input Tax Credit as per the provision in any of the following situation –

(a) When exemption to his supply of goods or services or both is withdrawn

(b) When he opts out of composition scheme

(c) When applies for registration after he becomes liable to pay GST.

GROUP: 4, PAPER: 19

COST & MANAGEMENT AUDIT (CMAD)

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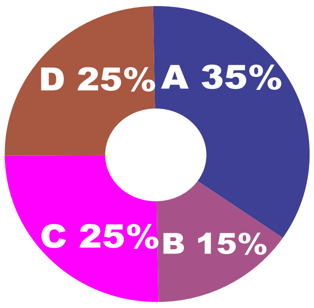
Your Preparation Quick Takes



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

Companies (Cost Records and Audit) Rules, 2014

Annexure – 1

Companies (Cost Records and Audit) Rules, 2014

[as amended upto 15th July 2014]

FORM CRA – 1

[Pursuant to rule 5(1) of the Companies (Cost Records and Audit) Rules, 2014]

A synopsis of certain important items of costs to be included in the Books of Accounts, is focused here under:

1. **MATERIAL COSTS:**

- Proper records shall be maintained showing separately all receipts, issue and balances in respect of each of raw material both in quantity and cost.
- Material receipt shall be valued at purchase price including duties, taxes, freight inwards, insurance (net of trade discounts, rebates etc.)
- Material issues shall be valued at FIFO or LIFO on weighted Average method on a consistent basis.
- Self-manufactured material or captive consumption shall be valued including direct material / labour / expenses and factory overheads along with share of Administrative Overhead.
- Normal loss or spoilage/Shrinkage/evaporation/gain etc in respect of materials shall be absorbed in the cost of balance materials.
- Normal scrap or defectives which are rejects shall be included in the material cost.
- Forex component of imported material shall be converted at the rate prevailing on the date of transaction.
- Subsidy of grant or incentives – any such payment received shall be get reduced from the cost of materials.
- In case of usage of standard cost the variances shall be treated as part of the cost of material.
- Charges payable to third party for processing or manufacturing a part of materials, shall be treated as part of the material cost.
- Sub-contracting charges, if any, should be directly assigned to the cost object.
- Indirect materials shall be assigned to the cost objects on the basis of actual usage or technical norms.
- Spares which are specific to an equipment should be capitalized.
- Cost of materials like catalysts, dies, tools, patterns, moulds etc. should be amortized over a period on suitable basis
- Some costs should be excluded from material cost – viz.
  - (i) Finance costs incurred with the acquisition of materials,
  - (ii) Any demurrage or detention charges paid or payable to transport or other authorities
  - (iii) Abnormal costs

2. **EMPLOYEE COST**

- Proper records shall be maintained to facilitate booking of expenses cost centre wise or department wise as appropriate. Where identification of specific cost centre is not possible, the expenses shall be apportioned to cost centres, service centres or departments on an equitable and reasonable basis.
- Employee cost shall cover gross pay including allowances payable. Bonus, exgratia are also part of employee cost.
- Managerial remuneration for executive directors and other officers are part of employee cost while remuneration of non-executive directors is booked into administrative overhead.

- Cost of Idle time shall be assigned direct to the cost object or treated as overhead depending upon specific circumstances.
- Where standard costing is being used normal variances are treated as part of the employee cost, while abnormal variances are considered as abnormal cost.
- Recruitment / training cost to be treated as overheads.
- Overtime premium shall be assigned directly to cost object or treated as overhead depending upon specific circumstances.
- Separation Costs related to voluntary retirement, retrenchment, termination etc are to be amortized over appropriate period.
- Certain types of cost should be excluded from employee cost – viz. (i) Abnormal Cost (ii) Imputed costs, (iii) Penalty, damages paid to statutory authorities or other third parties.

3. UTILITIES

- Proper records shall be maintained in respect of major utility such as power, water, steam, effluent treatment etc. showing the quantity and cost of each.
- Cost of Utilities purchased shall be measured at cost of purchase including duties, taxes, transportation charges etc net of trade discounts, rebates etc.
- Cost of self generated utilities for own consumption/for inter-unit transfer/for inter-company transfer/for sale to outside parties shall comprise direct material cost, direct employee cost, direct expense, factory overheads along with distribution cost, administration overheads where necessary. In case of sale to outside parties sale value should include requisite margin.
- Where standard costing is being used, variances shall form the part of cost of utilities. Abnormal usage variances are to be treated as abnormal cost.
- Certain type of cost shall be excluded from the cost of utilities – viz. (i) Finance Cost (ii) Imputed cost (iii) Abnormal cost and (iv) Penalties, damages paid to statutory authorities or other third parties.

4. DIRECT EXPENSES

- Proper records shall be maintained in respect of direct expenses in order to facilitate booking of these expenses cost centre – wise or department wise.
- Direct expenses incurred for bought out resources shall be determined according to invoice / agreed price including duties and taxes etc, net of trade discount, rebates etc.
- Direct expenses paid in lumpsum or which is in the nature of one-time payment shall be amortized over a period as appropriate.
- In case the direct expense does not meet the test of materiality, it shall be treated as overhead.
- Where standard costing is being used, variances that are normal should form part of direct expenses.
- Certain type of cost to be excluded from the direct expenses – viz. (i) Finance Costs (ii) Imputed costs (iii) Abnormal cost and (iv) Penalties, damages etc paid to statutory authorities or other third parties.

5. REPAIRS & MAINTENANCE

- Proper records showing expenditure incurred by the workshop, tool room and such work in the various cost center or departments shall be maintained under different heads.
- Relevant direct cost consists of consumable stores, spares, manpower, equipment usage, utilities and other identifiable resources consumed in such activity and indirect cost shall include the cost of resources common to various repairs and maintenance activities.
- Cost of repair & maintenance carried out by in – house works / outside contractors inside the entity shall include cost of material, consumable stores, spares, manpower, equipment usage, utilities and other resources.
- Such activity carried out by the contractors at their premises shall be determined at invoice or agreed price including duties and taxes, net of discounts.
- Cost of repair & maintenance activity shall be measured for each major asset category separately.
- Cost of spares replaced which do not enhance the future economic benefit from the existing asset, shall be included under repair and maintenance cost.
- High value spares when replaced by a new spare and is reconditioned which is expected to result in future economic benefit, shall be taken into stock. Normal reconditioning expenses may be charged to the cost of material. If the amount of expenditure is high, such expenses may be booked to overheads. Alternatively, the difference between the total cost of new spare plus the reconditioning cost and the value of the reconditioned spare shall be booked to repair and maintenance cost. [Cost of major overhaul shall be amortised over a period on a rational basis.
- Where standard costing is being used the emerging variances shall be treated as part of repair and maintenance cost, if normal. Abnormal variance shall be excluded.
- Certain types of costs should be excluded from repair and maintenance costs – viz. (i) Finance cost (ii) Imputed cost (iii) Abnormal costs and (iv) Fines, penalties, damages paid to statutory authorities or third parties.

6. FIXED ASSETS AND DEPRECIATION

- Proper and adequate records shall be maintained for assets used for production of goods or services in respect of which depreciation has to be provided for. The records shall indicate grouping of assets under each goods and services, the cost of acquisition of each item of assets including installation charges, date of acquisition and rate of depreciation.
- Depreciation and amortization shall be measured based on depreciable amount and useful life.
- The minimum amount of depreciation shall not be less than the amount as per principles and methods prescribed by the statute.

- Useful life of a depreciable asset should be estimated considering the following factors:
  - (i) Expected physical wear and tear
  - (ii) Obsolescence and
  - (iii) Legal and other limits on the use of the asset
- Useful life of an intangible asset shall not exceed the period of its contractual or legal rights. The useful life should not exceed 10 years from the date it is available for use.
- Depreciation of an asset shall be considered when such asset is first put to use.
- Depreciation of any addition or extension to an existing depreciable asset shall be based on the remaining useful life of the asset.
- Cost of small assets shall be written off in the period in which those are purchased.
- Depreciation of an asset shall not be considered in case cumulative depreciation exceeds the original cost of the asset, net of residual value.
- The impact of higher depreciation due to revaluation of asset shall not be assigned to cost object.
- Impairment loss on asset should be excluded from cost of production.

7. OVERHEADS

- Proper records shall be maintained for various items of indirect expenses comprising overheads pertaining to goods and services. Overheads shall be classified into functions viz Factory or works, Administration, selling and distribution, Head Office, etc.
- Overheads representing procurement of resources shall be determined at invoice or agreed price including duties & taxes, net of discounts.
- Where standard costing is being used, variances attributable to normal reason shall be treated as part of overheads while abnormal variances shall be excluded.
- Variable production overhead shall be absorbed to product or services based on actual capacity utilization.
- Fixed overheads shall be absorbed on the basis of normal capacity.
- Marketing overheads that can be identified to a product or service shall be assigned to that product otherwise it shall be assigned to the products on the most appropriate basis.
- Certain types of cost should be excluded from overheads – viz. (i) Finance Cost (ii) Imputed Cost (iii) Abnormal cost (iv) Fines, penalties, damages etc paid to the statutory authorities or other third parties.

8. ADMINISTRATIVE OVERHEADS

- Administrative Overheads shall be the aggregate of cost of resources consumed in activities relating to general management and administration of an organization
- In case of leased operating assets, the entire rentals shall be included in Administrative Overhead. In case of financial lease finance cost shall be segregated and treated as finance cost.
- The cost of software shall be amortized over its estimated useful life.
- The cost of administrative service procured from outside shall be determined at invoice or agreed price including duties & taxes, net of discounts.
- Overheads are to be apportioned to various cost objects in proportion to benefit received from them.
- Certain cost to be excluded from Administrative Overheads – viz. (i) Abnormal cost (ii) Fines, penalties and damages paid to statutory authorities or other third parties.

9. TRANSPORTATION COST

- Proper records shall be maintained for recording the actual cost of transportation showing each element of cost, viz. freight, cartage, transit insurance and others after adjustment for recovery of the transportation cost.
- In case of a manufacturer having his transport fleet proper records shall be maintained to determine the actual operating cost of vehicles showing various elements of cost, viz. salary and wages for driver and cleaner, cost of fuel, lubricants, repair & maintenance of vehicles, trips made etc.
- In case of hired transportation charges incurred for dispatch of goods, complete details shall be recorded, viz. date of dispatch, type of transport used, description of goods, name of consignee and destination, quantity of goods, distance involved, amount paid etc.
- Records of transportation of goods for trading activities shall be maintained separately.
- Records for transportation cost of exempted goods, excisable goods cleared for exports shall be maintained separately.
- Records shall be maintained for inward and outward transportation cost showing details of goods, name of supplier or recipient, amount of freight etc.
- Depending upon nature of products, units of measurement followed and type of transport used. Certain bases shall be used viz.
  - (i) weight,
  - (ii) volume of goods
  - (iii) percentage of usage of space. Basis shall be followed consistently.
- Abnormal cost shall be excluded.

10. ROYALTY AND TECHNICAL KNOW-HOW

- Adequate records shall be maintained showing recurring as well as non-recurring payment of similar nature.
- Lump-sum or one-time payment shall be amortized on the basis of estimated output or benefit to be derived from the related asset.
- The relating expenses, if traceable shall be assigned to the particular cost object, otherwise those shall be assigned to any of the basis viz. (i) units produced (ii) units sold (iii) sales value.

- Amount of royalty fee paid for mining right, shall from part of the cost of material.
- Certain costs are to be excluded – viz (i) Finance costs (ii) Imputed costs (iii) Penalties, damages etc paid to statutory authorities or other third parties.

11. RESEARCH & DEVELOPMENT EXPENSES

- R&D cost shall include all directly traceable cost or that can be assigned to R&D activities strictly on the basis of (a) cause and effect or (b) benefit received, and such costs shall include the following elements:
  - (i) Cost of material and service consumed.
  - (ii) Cost of bought out materials and hired services as per invoice or agreed price.
  - (iii) Salaries, wages and other related cost of personnel engaged in R&D activities.
  - (iv) Depreciation of equipment & facilities, other tangible assets and amortization of intangible assets used.
  - (v) Overhead cost related to R&D activities
  - (vi) Expenditure towards copyrights, licences, developing computer software, design of tools, jig, moulds and dies.
- Development cost resulting in creation of an intangible asset shall be amortized over its useful life
- If technical know-how is provided to outside party, the cost involved shall be accumulated separately towards development cost.
- Costs to be excluded viz. (i) imputed cost (ii) Abnormal cost and (iii) Fines, Penalties, damages etc. paid to statutory Authorities or other third parties.

12. QUALITY CONTROL EXPENSES

- Adequate records shall be maintained for expenses in respect of quality control department.
- Cost of resources procured from outside shall be determined at invoice or agreed price. Quality cost incurred in-house shall be the aggregate of the cost of resources consumed in such activity. Depending upon the conformance to quality, such costs may be (i) Preventive Cost and (ii) Appraisal Cost.
- Cost directly traceable to the cost object shall be assigned to that cost object. Assignment where needed shall be based on benefit received by the cost objects.
- Costs to be excluded – viz. (i) Finance Cost (ii) Imputed cost (iii) Abnormal cost and (iv) Penalties, damages etc paid to statutory authorities or other third parties.

13. POLLUTION CONTROL EXPENSES

- Adequate records of expenses shall be maintained. The basis of apportionment on the related goods and services and other goods and services shall be made on equitable and rational basis.
- Direct cost includes cost of materials, consumable stores, spares, man-power, equipment usage, utilities, resources for testing etc while indirect cost includes pollution control registration and such like expenses.
- Relating costs which are internal to the entity shall be accounted for when incurred
- Future remediation or disposal cost shall be estimated and accounted for based on quantum of pollution generated in each period.
- In case of in-house pollution control activities, total cost includes cost of material, consumable stores, spares, manpower, equipment usage, utilities and other resources used.
- In case of such activity carried out by outside contractors inside the entity, cost shall be determined by their charges which include total cost as above.
- Pollution control costs shall be traced to a cost object to the extent economically feasible. Where the cost is not directly traceable to cost object it shall be treated as overhead and apportioned to various cost objects in proportion to benefit received by them.
- Cost to be excluded – viz. (i) Finance costs (ii) imputed costs (iii) Abnormal Cost and (iv) Fines, Penalties, damages etc. paid to statutory authorities or other third parties.

14. SERVICE DEPARTMENT EXPENSES

- Proper records shall be maintained in respect of service departments (i.e., cost centres) which normally provide service to other cost centres viz. engineering, workshop, designing, laboratory, safety, transport, computer cell, welfare centre etc.
- Service cost centre accounts for both direct and indirect cost, which broadly covers cost of material, consumable stores, spares, manpower, equipment usage, utilities and other resources including overheads.
- Cost of services include distribution costs in case of inter unit or inter-company transfers.
- Where standard costing is being used, price and usage variances are treated as part of service cost.
- Cost to be excluded – viz. (i) Finance costs (ii) imputed costs (iii) Abnormal Cost and (iv) Fines, Penalties, damages etc. paid to statutory authorities or other third parties.

15. PACKING EXPENSES

- Proper records shall be maintained separately for domestic and export packing showing quantity and cost of various packing materials including valuation in respect of primary and secondary packing.
- The packing material receipt shall be valued at purchase price including duties, taxes, freight inwards, insurance and other expenditure, net of discounts rebates etc.
- Self-manufactured packing materials shall include direct material cost, direct employee cost, direct expenses, job charges, factory overheads, share of administrative overhead and R&D cost incurred for development and improvement of existing process or product.
- Normal loss or spoilage of packing material shall be absorbed in the cost of balance material.
- In respect of Forex component of imported packing material, cost shall be converted at the rate prevailing on the date of transaction.

- Packing material cost shall be directly traced to a cost object to the extent it is economically feasible. Otherwise the costs may be assigned to the cost objects on the basis of quantity consumed or on technical estimate.
- Costs to be excluded – viz. (i) Finance costs (ii) imputed costs (iii) Abnormal costs and (iv) Demurrage / Detention charges penalties paid to the transport or other agencies.

16. INTEREST AND FINANCING CHARGES

- These costs are incurred by an enterprise in connection with borrowing of fund or other costs representing payment for use of Non-equity fund.
- Interest and financing charges incurred shall be identified for (i) Acquisition and construction or production of qualifying assets including Fixed Assets and (ii) other financing costs for production of goods or operation or services rendered which cannot be classified as qualifying assets.
- The relating cost can be apportioned to various cost objects in proportion to the benefits derived by them.
- Cost to be excluded – viz. (i) Imputed cost (ii) Penal interest for delayed payment, fines, damages etc paid to statutory authorities on other third parties.

17. ANY OTHER ITEM OF COST

- Proper records shall be maintained for these costs being indispensable and considered necessary for inclusion in cost records for calculating cost of production of goods or rendering of services, cost of sales, margin in total and per unit of goods or services under reference.

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YEARS OF CELEBRATING THE MAHATMA

Dr. Ashish Kumar Sana
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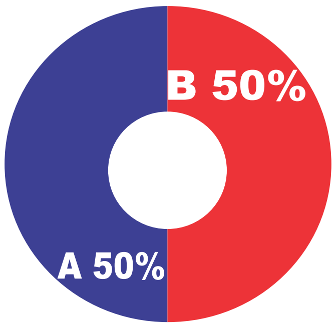
GROUP: 4, PAPER: 20

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 free cash flow valuation
- solve the problems on free cash flow valuation

Free Cash Flow Valuation

Free cash flow represents the return to all providers of capital, whether debt or equity. It can be used to pay off debt, repurchase shares, pay dividends or be retained for future growth opportunities. It is the hard cash that is available to pay the company's various claim holders, especially the shareholders.

Free cash flow valuation defines the value of the firm to be the present value of its expected future cash flows discounted at the company's cost of capital. Free Cash Flow to Equity (FCFE) is a measure of how much cash can be paid to the equity shareholders of the company after all expenses, reinvestment and debt repayment. Free cash flow to equity (FCFE) represents the cash flow a company generates after necessary expenses and expenditures and after satisfying the claims of debt holders.

Free cash flow to (FCFF) can be calculated as under:

FCFF = Net Operating Profit - Taxes - Net Investment - Net Change in Working Capital or

FCFF = Net Income + Non Cash Charges + Interest (1-T) - Net Investment - Net Change in Working Capital

A positive value would indicate that the firm has cash left after expenses. A negative value, on the other hand, would indicate that the firm has not generated enough revenue to cover its costs and investment activities.

FCFF can be calculated from the statement of cash flows as follows:

FCFF=Cash Flow from operations + After-tax interest expense - Capital expenditures

Free Cash Flow to Equity (FCFE) can be calculated from Free Cash Flow to the Firm (FCFF) as follows:

FCFE = FCFF - After-tax interest expense + Net borrowing

Once the free cash flows are estimated from the right perspective, the value of the firm is the sum of the present values of the free cash flows for a "planning period" plus the present value of the cash flows beyond the planning horizon (i.e., the terminal value), i.e.,

$$= \sum_{t=1}^{T} \frac{FCF_1}{(1+k)^t} + \frac{FCF_{t+1}}{k-g} \times \frac{1}{(1+k)^T}$$

Where,

g = growth

t = time

k = cost of equity

To find the value of a firm, debt holders and/or contributors of debt and equity capital, would discount FCFF by weighted average cost of capital (WACC). Similarly, the equity shareholders would discount FCFE by cost of equity.

FCFE Models:

(I) Stable-growth FCFE Model:

The value of equity, under the stable-growth model, is a function of expected FCFE in the next period, the stable growth rate, and the required rate of return.

$$P_0 = \frac{FCFE_1}{r - g_n}$$

P_0 = Value of stock today

FCFE = Expected FCFE next year r

r = Cost of equity of the firm

g_n = Growth rate in FCFE for the firm forever.

(II) Two stage and three stage FCFE model

(a) Two stage FCFE model :

The value of any stock is the present value of the FCFE per year for the extra ordinary growth period plus the present value of the terminal price at the end of the period.

Value = PV of FCFE + PV of Terminal price

$$= \sum_{t=1}^{t=n} FCFE_1 (1+r)^t + P_n (1+r)^n$$

Where

FCFE= FCFE in year t

P_n = Price at the end of extra ordinary growth period

r = Required rate of return to equity investors in high growth period calculated using CAPM

The terminal price is generally calculated using the infinite growth rate model.

$$P_n = FCFE_{n+1} (r_n - g_n)$$

g_n = Growth rate after the terminal year forever

r = Required rate of return to equity investors in stable-growth period.

$$P_0 = \sum_{t=1}^{t=n_1} \frac{FCFF_t}{(1+r)^t} + \sum_{t=n_1+1}^{t=n_2} \frac{FCFF_t}{(1+r)^t} + \frac{P_{n_2}}{(1+r)^{n_2}}$$

Where

P_0= Value of stock today

$FCFE_t$ = FCFE in year t

r = Cost of equity

P_{n2}= Terminal price at the end of transition period

n_1= End of the initial high growth period

n_2= End of transition period

Illustration:

Assume that a firm is expected to have earnings growth of 20% for the next five years and 5% thereafter. The current earnings per share is \$2.50. Current capital spending is \$2.00 and current depreciation is \$1.00. Further assume that capital spending and depreciation grow at the same rate as earnings and there are no working capital requirements or debt. Calculate Free Cash Flow to Equity in five years.

Answer:

Earnings in year 5 = 2.50 * (1.20)5 = $ 6.22

Capital spending in year 5 = 2.00 * (1.20)5 = $ 4.98

Depreciation in year 5 = 1.00 * (1.20)5 = $ 2.49

Free cash flow to equity in year 5 = $6.22 + 2.49 - 4.98 = $3.73

If we use the infinite growth rate model, but fail to adjust the imbalance between capital expenditures and depreciation, the free cash flow to equity in the terminal year is –

Free cash flow to equity in year 6 = 3.73* 1.05 = $ 3.92

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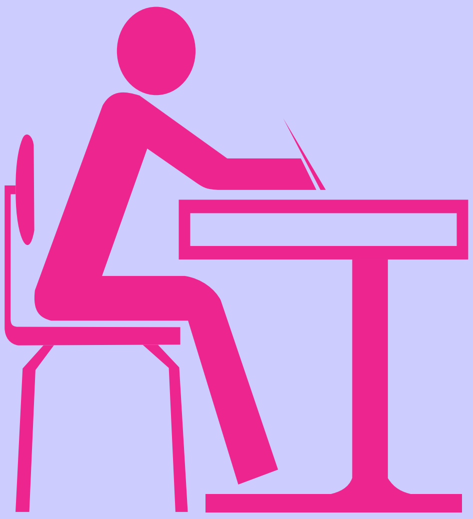
YEARS OF CELEBRATING THE MAHATMA



Examination TIME TABLE

THE INSTITUTE OF COST ACCOUNTANTS OF INDIA
(Statutory body under an Act of Parliament)

Day & Date	Final Examination Syllabus-2016 Time 2.00 p.m. to 5.00 p.m.
10th December, 2019 (Tuesday)	Corporate Laws & Compliance (Paper 13) (Group - III)
11th December, 2019 (Wednesday)	Corporate Financial Reporting (Paper 17) (Group - IV)
12th December, 2019 (Thursday)	Strategic Financial Management (Paper 14) (Group - III)
13th December, 2019 (Friday)	Indirect Tax Laws & Practice (Paper 18) (Group - IV)
14th December, 2019 (Saturday)	Strategic Cost Management - Decision Making (Paper 15) (Group - III)
15th December, 2019 (Sunday)	Cost & Management Audit (Paper 19) (Group -IV)
16th December, 2019 (Monday)	Direct Tax Laws and International Taxation (Paper 16) (Group - III)
17th December, 2019 (Tuesday)	Strategic Performance Management and Business Valuation (Paper 20) (Group - IV)

Rescheduled Examination TIME TABLE

THE INSTITUTE OF COST ACCOUNTANTS OF INDIA
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(FOR JHARKHAND STATE ONLY)

RESCHEDULED EXAMINATION TIME TABLE & PROGRAMME OF DECEMBER 2019 TERM FOR ASSEMBLY ELECTION ON 12/12/2019 FOR RANCHI (315) & HAZARIBAGH (328) AND 16/12/2019 FOR BOKARO (304) & DHANBAD (308) TO BE HELD ON 7TH JANUARY - 2020

Day & Date	Foundation Examination Syllabus-2016 Time 2.00 p.m. to 5.00 p.m.	Intermediate Examination Syllabus-2016 Time 2.00 p.m. to 5.00 p.m	Final Examination Syllabus-2016 Time 2.00 p.m. to 5.00 p.m.
7th January, 2020 (Tuesday)	PROGRAMME FOR RANCHI (315) & HAZARIBAGH (328)		
	Fundamentals of Laws & Ethics (Paper 3)	Laws & Ethics (Paper 6)	Strategic Financial Management (Paper 14)
	PROGRAMME FOR BOKARO (304) & DHANBAD (308)		
	-------	Cost Accounting (Paper 8)	Direct Tax Laws and International Taxation (Paper 16)

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
Webinar seasons

02 Solve Excercises given in Study Note

03 Assess Yourself

04 Appear For Examination

FINISHED

SUBMISSION

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.

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.

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

Message from

Directorate of Studies

Dear Students,

We from the Directorate of studies know your expectations from us and accordingly we are trying to delivery 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 Book, and we have conducted Webinar sessions. Before stepping in to the examination hall, please go through the PPTs on "Achieve your GOAL"; Uploaded by the Directorate of Studies and which will help you to know about certain Do's and Don'ts in the examination.

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:

"Whatever you do will be insignificant. But it is very important that you do it",

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 links mentioned below :

For Mock Test Papers (MTP) : **https://icmai.in/studentswebsite/mtp2016_j19_Final.php**

For PPT on "Achieve your GOAL : **http://icmai.in/studentswebsite**

For Work Book Link : **https://icmai.in/studentswebsite/Workbook-Syl-2016-Final-March2019.php**

Live/Recorded Webinar Link : **https://eicmai.in/Webinar_Portal/Students/StudentLogin.aspx**

Ebulletin Link : **https://icmai.in/studentswebsite/E-Bulletin.php**

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

You can win !

We are sure that you will be motivated after looking into the placement news of our students' appeared in the Times of India, newspaper.

Anticipate Victory, Prepare for triumph.
GOOD LUCK in your exams!

Few Snapshots

CMA Balwinder Singh President ICAI and Shri. K Sankaranarayanan Ex-Governor of the Indian state of Maharashtra, Nagaland & Jharkhand inaugurating Thrissur Chapter events by lighting the lamp. With them are CMA H Padmanabhan Council Member ICAI, CMA Dr PVS Jaganmohan Rao President SAFA, CMA Jyothi Satish Chairperson and CMA Sankar Panicker VC ICAI SIRC and CMA T G Sugunan Chairman & MCMs Thrissur Chapter

16th National Awards for Excellence in Cost Management 2018 on October 25, 2019

Seminar on Sabka Viswas (Legacy Dispute Resolution Scheme) 2019 organised by the Tax Research department of the Institute in association with PD Committee of EIRC on 24th October 2019 at CMA Bhawan, Kolkata. Shri Rupam Kapoor, IRS, Principal Commissioner CGST and Shri Suryateja, Joint Commissioner CGST graced the occasion as Chief Guests.

Seminar on Direct and Indirect Tax organised by the Tax Research department of the Institute in association with Bengaluru Chapter on 20th October 2019. Shri Ajaya Saxena, IRS, Principal Commissioner CGST and Shri S V S S Prasad, IRS, Principal Commissioner Income Tax graced the occasion as Chief Guests.

CMA Balwinder Singh, President of the Institute welcomes Mr. Benrodgers M. Milaih, Board Member of Kenya Accountants and Secretaries National Examination Board (KASNEB) on 5th November 2019 at CMA Bhawan, New Delhi.

THE INSTITUTE OF COST ACCOUNTANTS OF INDIA

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Behind every successful business decision, there is always a CMA