



# The Chartered Accountant Student

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## Message from the President

Beloved Students,

It is my pleasure to wish you all a very successful, happy and healthy new year 2007. I wish those who are awaiting the examination results all the best. Many of the existing students in PE-I are switching over to CPT. New enrollment to CPT more particularly from among those who are studying 11<sup>th</sup> & 12<sup>th</sup> standards, is overwhelming. This indicates that the parents, teachers and students are in favour of the new curriculum. The objective behind new curriculum is to “catch them young” and “catch the cream”.

### Salient Features

The salient features of the new course that are instrumental in attracting the cream of the younger generation are (i) reduced duration of the course - from 5½ years to 4 years; (ii) modernising of syllabus to meet the expectation of the business, regulators and global players; and (iii) blending of theoretical education with practical training. Besides, the acute shortage of CAs in India and abroad and buoyancy of the economy and commerce has resulted in attractive pay package for a fresher CA. An Indian CA can get a job and settle down anywhere in the world. This sense of global job security and possibility of qualifying by the age of 21 and settling down in life is attracting more students, especially girls to the CA curriculum.

### Planning

In order to qualify as a CA without losing time, a student should plan well. Time management is most important. You may retrieve everything but not the



time lost. Every minute is so valuable that you ought to spend it effectively to shape your future and lay a strong foundation. If you are failing to plan, it means that you are planning to fail. A weekly planner should help you to allocate and utilize time in the most prudent manner. You must ration your time to sleep well, to eat healthy food and to recreate your mind with good habits like listening to music, doing exercise, reading books, watching meaningful programs on a selective basis. The entire remaining time should be devoted to your studies.

### Hard work

Nothing worth remembering is achievable without working for it. You need to sweat out to accomplish your goal. There is no gain without pain. You need to sacrifice your hobbies and social habits to a certain extent in order to devote more time in preparing for the examination. Hard work never goes unrewarded. Luck is like a lift and hard work is akin to staircase. Lift may not work but staircase always awaits to take you to the top. If you work hard at this age, the rest

of your life would be bright and enjoyable. If you hardly work now then for the rest of your life you may have to slog even to sustain basic necessities. The choice between these two options is clearly yours.

**Perseverance**

Goals set may not always be smoothly achievable. There could be bottlenecks and difficulties. One must have the determination and zeal not to give up or feel discouraged. Winners never quit and those who quit do not win. Future belongs to those who pursued their tasks unmindful of problems encountered. When going gets tough, the tough get going. You can make your future by viewing hurdles as stepping-stones. Perseverance makes all the difference between success and failure. No one can prevent you from being successful unless you decide not to fight and to give up.

**Attitude**

Many students do not appear to be sure about the attitude to be adopted in life. I would suggest that be a ‘pessimist’ when you are preparing for an examination or a competitive event. Expect the unexpected or difficult situation and accordingly equip yourself. But when you actually perform in the examination or in any competition be an ‘optimist’. Nothing should deter you from giving your best. Believe that you are the best and leave no stone unturned till you accomplish. While the aeroplane was invented by optimists, parachute was invented by a pessimist. Be well prepared and equipped for any competitive event including an examination so that nothing can go wrong. Even if something goes wrong, you will still land safely and securely.

**Knowledge and skills**

This is the stage in your life when you can develop soft skills and build a knowledge bank within you. A strong foundation in this regard laid during student days will help you later in life when you go up the ladder or when you get elevated to greater positions. Leisure time should be used for general reading; and to develop linguistic, technological and managerial skills. These add to your profile and provide you the edge over others in every competitive situation.

**Self Confidence**

Shred inferiority complex, which makes you believe that there are impossible things in life. If you think you can, you will do it. You ultimately become what you want to be, if only you possess self-confidence. Many times, you may get a feeling that you have come to the end of the road. If you tackle that situation with utmost confidence, then you will realize that it is not the end but only a bend in the road and you can reach the destination with slight modification in the approach. Confidence is nothing but inner strength.

Even if everything seems to have been lost, always remember that future remains and awaits you. Plan properly; be at your best in anything you do; never give up your aspiration or effort; adopt the right kind of attitude and be ever confident. Your quest for knowledge and skill set should be unparallel and unlimited. I can assure that if you imbibe these attributes, success will be at your beckoning. May your aspirations become reality in 2007 and thereafter. All the very best.

Yours affectionately,



Place : New Delhi

Date : December 22, 2006

**CA. T.N. Manoharan**  
**President, ICAI**

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## Global Convergence in Financial Reporting

CA. Parveen Sharma

Cross-border capital flows in today's liberalized economic conditions demand fairly high standards of accounting information in corporate financial reporting. Transparency and adequate disclosure of financial statements has enhanced decision-making and efficiency of resource allocation in the economy. In recent times, companies are increasingly raising capital and attracting major investors from outside their home countries.

Accounting research has shown that foreign investors are attracted to firms that use accounting standards with which they are familiar. Further, the findings of a recent research also suggest that the cost of capital is lowered for firms that adopt international accounting standards. Accounting standards are crucial for companies for effective participation in the global market.

The World Investment Report (WIR), 2005 of the United Nations Conference on Trade and Development (UNCTAD) reveals that the stock of Foreign Direct Investments (FDIs) alone were estimated at US\$9 tn in 2004. China remained the most favored destination of investors not only among countries in the Asian region but also among developing economies all over the world. A report of the World Bank also indicates that India ranks low among hot-destinations for FDI inflows into the country.

Today, invariably, the Chartered Accountant body of every country is laying down accounting standards to be followed in that country. The IASC comprising professional accounting bodies of over 85 countries who are members of the IFAC prepare the International Accounting Standards (IAS) to serve as a benchmark for setting national Standards and/or to be used directly by multinational Corporations (MNCs). Of late, a new board has been constituted for setting international accounting standards under the name International Accounting Standards Board (IASB), which has started its operation under the aegis of the International Accounting Standards Committee Foundation (IASCF). The IASB is issuing accounting standards named as international Financial Reporting Standards (IFRS), which are permitted by IASC Foundation Trustees. With the emergence of the global market due to the massive liberalization drive adopted by majority of the countries, varied standards of accounting in different geographical zones need harmonization.

In India, the Accounting Standards (AS) issued by the Accounting Standards Board (ASB) of the Institute of

Chartered Accountants of India (ICAI) is primarily based on IAS issued by both the IASCF and IASB. This article analyzes the harmonization efforts of the Indian Standard Setting Body between Indian and International accounting standards for making Indian companies globally competitive.



### Rationale for Formulating Accounting Standards

Differences in GAAPs of two countries exist due to the prevalence of different accounting rules of measurement, different interpretations of similar rules and varying degrees of financial statements. Elimination of such diversity in accounting practices is necessary through the formulation and use of accounting standards so that the accounts and financial statements of business organizations based on these standards will reveal the true and fair view of their operations. Thus, the logic of standard setting is based on the necessity of harmonizing the diverse policies and practices adopted by different enterprises and ensuring consistencies in reporting of financial and accounting information from, year to year. Financial reports prepared by using accounting standards possess values in terms of content, uniformity and comparison. Currently, accounting standards have emerged worldwide as major components in the framework of accounting and reporting practices.

### Need for the Convergence of Accounting Standards

Over the years, countries have been evolving their own accounting standards to use in business. Financial statements prepared in one country are often not accepted in other countries. The reason is that the accounting standards are derived from the process that involves legal, economic, social and cultural considerations. Business practices, legal and fiscal framework, and economic and social conditions differ in different countries and these differences are reflected in the national accounting standards. Thus, differences in accounting standards followed by individual countries create difficulties for the operation of today's international business that is growing at a fast pace- The World Investment Report. 2005 reveals that 70,000 Transnational Corporations (TNCs) with their 6.90 lakh affiliates were operating in the world in 2005. Sales by these 6.90 lakh affiliates alone accounted for \$19 tn in 2004. Hence, a TNC operating in several countries has to prepare accounts as per the accounting standards prevalent in each of these countries thus preparing varying types of financial statements is somewhat

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cumbersome, expensive and time consuming. The Securities and Exchange Commission (SEC) of the US requires that companies listed in the US Stock Exchanges are to prepare accounts as per the US GAAP. Hence, harmonization of national accounting standards is necessary to save costs and to enhance the quality and comparability of such standards. The following are the important reasons attributed to the need for convergence of national accounting standards:

1. Convergence of accounting standards would create easy and faster access to investment opportunities for all kinds of investors around the globe by integrating global capital markets through the means of providing comparable financial information.
2. The conduct of international business will be facilitated to a greater extent if the firms are using uniform, i.e., harmonized accounting standards.
3. Globalization of trade and commerce, which is taking place at a rapid pace, has created an urgent need for the convergence of accounting and auditing standards and Practices.
4. MNCs are demanding more uniform standards in order to have uniform reporting from the subsidiaries across the globe.
5. The practice of following harmonized accounting standards would standardize the accounting procedures in accordance with political and trade harmonization among countries like South Asian Association for Regional Cooperation (SAARC), Association of South East Asian Nations (ASEAN), European Union (EU), North American Free Trade Agreement (NAFTA), South Asia Free Trade Agreement (SAFTA), etc.

### Current Global Scenario of Convergence of Accounting Standards

Though talks have commenced for global convergence of accounting standards sometime back, the progress has been tardy. In view of this, it has convinced many that the US GAAP would be the *de facto* standards and the IFRS or IAS would be the sound set of principles to base national GAAP. The European Commission has been harmonizing accounting standards in order to promote free flow of capital among European countries. However, the most notable development is the European Commission's endorsement of IFRS and its agreed road map with the SEC is to remove the requirement for foreign private issuers to reconcile financial statements prepared under IFRS to the US GAAP by 2009. The next logical goal for the IASB would be to converge US GAAP with IFRS. This has met with some validation with the SEC stating that if the IASB-FASB convergence project results in a set of converged high

quality standards, it would begin the process of reconciliation within a decade.

The Canadian Accounting Standards Board announced that it would implement IFRS within five years. They are emphatic about the use of IFRS despite the fact that within this period the whole of North America would not be an IFRS friendly zone. The convergence effort between IASB and the Accounting Standards Board of Japan has already been on, in spite of the threat of an early walkout by the latter. China has also been using accounting standards since 1993, which were prepared more in the light of International Accounting Standards. However, China has also asked IASB to send out a team later this year to Beijing to discuss the differences between IFRS and Chinese Accounting Standards.

### Indian Scenario of Convergence of Accounting Standards

Indian Accounting Standards (AS) issued by ICAI by and large are based on IAS. Further, Indian companies listed in the US bourses have converted their accounts to meet the requirements of the US GAAP. However, the ICAI has given concessions to Small and Medium Enterprises (SMEs) and banks to fine-tune accounting standards to meet certain situational contingencies.

Since February 21, 2005, the IASC (now IASB) has issued 41 IAS and six IFRS and withdrawn ten IAS. In addition to it, one more international accounting standard i.e., IAS-4, though has been withdrawn, is included as corresponding Indian accounting standard AS-6 is in force, to make a total of 38 international accounting standards. It is further revealed that ICAI has issued 29 AS, one guidance note and seven are in the process of preparation; two more international accounting standards IAS-29 (Financial Reporting in Hyper-inflationary economies) and IFRS-1 (First time adoption of IFRS), which are considered not relevant in India if included to the lists of accounting standards issued by ICAI, the total is 38. The close analysis of the foregoing statistical figures indicates that in India, the ICAI has been continuing its efforts for bringing harmonization between Indian accounting standards and international accounting standards.

The Securities and Exchange Board of India (SEBI) has also set up a Standing Committee on Accounting Standards to monitor the existence of relevant accounting Standards and their harmonization with corresponding International Accounting Standards. It mandates the adherence to standards and enforces the same through the listing agreements between the companies and recognized Stock Exchanges. The Companies Amendment Act 1999 has made compliance with accounting standards mandatory in India.

**Key Differences between Indian GAAP and US GAAP**

Nature of Items	Indian GAAP	US GAAP
Revaluation of Fixed Assets	Revaluation of fixed assets is permitted by creation of a revaluation reserve, which is not available for distribution.	Upward revaluation of long-lived assets is not permitted.
Change of Accounting Policies	Impact of change In accounting policies and prior period items are reported on a prospective, if material, basis beginning with the year of change.	Prior period items are accounted by adjusting to prior years and retained profits.
Inventory Valuation	Inventories are valued at the lower of cost and net realizable value. AS-2 permits only FIFO or weighted average cost formula for determining the cost of Inventories,	Lower of cost or market except in certain exceptional cases. Allows even LIFO method of valuation.
Revenue Recognition	AS 9 requires revenues to be recognized when significant risk and rewards of ownership are transferred and no significant uncertainty exists over collection.	Revenue recognition under US GAAPs is complicated and requires particular scrutiny when companies prepare their accounts.
Extraordinary Items	Extraordinary items are disclosed separately by way of note without adjustment for the tax effect thereof.	Extraordinary Items are required to be shown net of tax. below income from continuing operations.
Depreciation Rates	Depreciation rates are prescribed in the Companies Act for minimum depreciation provisions for the purpose of payment of dividends out of profits for the year.	Depreciation rates are derived on the basis of useful economic life of the asset.
Costs of Fixed Assets	Under Indian GAAP indirect preoperative expenses incurred during construction are capitalized.	Under US GAAP such indirect cost are expensed as and when incurred.
Balance Sheet Classification	The balance sheet classification of assets and liabilities is determined by the form and manner specified in Schedule VI, Part 1 of Companies Act, 1956.	There is no specific requirement under US GAAP to present a classified balance sheet. However, it is a common practice to present a classified balance sheet.
Capital Stock	Although India GAAP does not have any accounting pronouncements as regards 'share capital' and 'reserves and surplus', the Companies Act, 1956 sets out the disclosure requirements in this area.	Disclosure of changes in the separate accounts comprising stockholders' equity (in addition to retained earnings) and of the changes in the number of shares of equity securities during at least, the most recent annual fiscal period is required.
Cash Flow Statement	Enterprises report cash flows from activities using either the direct method or the indirect method.	FAS-95 encourages enterprises to report cash flows from operating activities directly by showing major classes of operating cash receipts and payments (the direct method).
Deferred Income Tax	The provision for taxation under Indian GAAP consists of the estimated tax currently payable and deferred income taxes for timing differences between accounting income and taxable income at the substantively enacted income tax rates.	US GAAP requires that a provision for such deferred income taxes be made for the future tax effects of temporary differences between book and tax basis of assets at the enacted tax rates.
Debt Issue Expenses	Debt Issue expenses may be capitalized or charged to share premium,	Debt Issue costs are amortized over the life of the debt.
Share Issue Expenses	Share issue expenses can be written off when Incurred or charged to the share premium account or can be accounted for as deferred revenue expenses and amortized.	Direct costs of issuing share capital price are deducted from the related proceeds and the net amount is recorded in shareholders equity.
Employee Benefits	Provision for leave encashment is accounted for on actuarial valuation basis.	Provision for leave encashment is accounted on actual basis. Compensator towards voluntary retirement scheme is charged in the year In which the employees accept the offer.

Consolidation of subsidiaries	AS 21 is not mandatory. SEBI has made it mandatory for listed companies. No provision in Companies Act for consolidation.	Consolidation is required.
Goodwill	AS 26 recognizes only purchased goodwill and not self-generated goodwill and suggests the amortization over ten years. However, goodwill arising as per AS 14 'amalgamation by way of purchase' is amortized over five years.	Goodwill is amortized over period not exceeding 40 years for Institute that register with SEC. Twenty years is generally viewed as maximum period of amortization.
Proposed dividends	Proposed dividends are reflected in the financial statements of the year to which they relate even though proposed or declared after the year-end.	Dividends are charged to retained earnings at the point of time that they are formally declared by the Board of Directors.
Investments in associated Companies	Equity method is not used for companies. Investments are carried at cost. AS 23 prescribes equity method only for consolidated financial statement.	Investments in associated companies associated are accounted by equity method.
Investments: Debt and Equity Securities	AS 13 requires current investments to be carried at the lower cost and fair value and long-term investment at cost, except for other than temporary decline value. The aggregate market values of quoted long-term investments are required only to be disclosed, not adjusted.	Debt and equity securities are classified as 'trading, held to maturity and available for sale. Securities held to maturity are stated at cost, adjusted for any amortization of premium or discount and subject to any diminution in value. Trading securities are held at market value and profit and losses arising from revaluation are taken to the profit and loss account. Available for sale securities reported at market value with net unrealized gains and losses excluded from earnings and reported as a separate component of shareholders' equity. <span style="float: right;">□</span>

### Invitation to CA Students to Contribute Articles

Students are invited to write articles in the subject areas. Although, in recent past we have received poems or brief write-up, we feel that newsletter can be effective medium for the students to share their knowledge. Such articles should be written after thorough understanding of the topic and after referring to several good books and journals. They may add their own views on contemporary developments in the chosen topic.

Every year best articles that are written by students are awarded cash prize and a certificate at the annual function of the Institute.

All correspondence in this regard should be done at Board of Studies, ICAI, C-1, Sector – 1, Noida 201301. Emails can be sent to [casnewsletter@icai.org](mailto:casnewsletter@icai.org). Please write your complete name, address and the registration number in your correspondence.

## Financing An Infrastructure Project

Alok Shankar & Ankita Srivastava

### Introduction

In a developing economy like India the most important sector, which requires the Government attention and development is the infrastructure. In our journey in the twenty-first century when the Indian economy is all set to integrate itself into the global economy, the upgradation and modernisation of infrastructure and its efficient use have assumed critical importance.

As this is a capital-intensive sector, there is an obvious need for perspective planning with a vision for the next twenty years and to muster all the resources of the country. But the irony of the situation is that the government is perennially resource starved. Therefore the only apparent solution is private sector participation. As has always been the state in this sector the discouraging factor to private investment is mammoth investment (consequently immense risk) and prolonged gestation period, thus, private developers would not be willing and even be in a position to invest. Then there are inherent risks like bankruptcy and financial ill health of the sponsor. The outcome is that even in a project developed by a private operator, most part of it is public money, which goes into it through the banks, FI's and other equity investments raised directly from people.

The most important question becomes 'what guides the lenders to fund such big projects with securities which they always know that if the project does not work then the securities would fall short of the total exposure. Especially in the prevailing Indian financial sector, banks and financial institutions are legally and financially equipped to raise funds for five to seven years only. Hence, they would be hesitant to deploy such funds for longer period and face problems at the time of paying their own liabilities.

There are several legal and financial risks at each level - construction, operation, revenue collection, etc. All traditional securities that are created by lenders in other loans would not be possible in infrastructure financing and even if some are created they would not be enough to repay the full amount in the event of the project not being successful. Then what guides the lenders and how does the RBI prevent wasteful use of public money?

### List of Participants

An infrastructure project being developed with the participation of the private sector stands out in terms of the number of participants and also their diverse interests.

Mainly it includes

1. The sponsor
2. The lender
3. The investor
4. The project vehicle
5. The user

In addition to the above mentioned, the support of the government, contractors and the other agencies (like regulatory agencies and authorities) are also required.

- ◆ The group that is seeking or has been selected to implement the project is referred as **Sponsor or Promoters or Developers**.

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- ◆ The persons investing money are called **Investors**. They generally invest through equity, long term unsecured loans and convertible debentures.



- ◆ The group of legal entity (Banks, FI's and others) that provide debt financing

for the development of the project are referred as lenders. They are different from investors and sponsor in the sense that they lend money on commercial terms for the development of the project while the investors and sponsor seek to get involved in the project i.e. the investors seek to acquire participatory interest in the project. It is not uncommon to find the same entity to be an investor with regard to a particular amount and be a lender with regard to the other.

- ◆ A particular entity vested with the rights to implement the project is commonly referred as **Project Vehicle or Special Purpose Vehicle**. The sponsors generally seek to instrument a project through a special legal entity formed by them. The risk in such structuring is transferred to the special vehicle and insolvency and financial health of the sponsor does not affect the project progress.

- ◆ Generally any infrastructure project is commissioned for the use of general public or a group of people represented by any consumer group and even the government at times. However, it is not uncommon especially in this age of competition to have infrastructure projects being commissioned for single individual user also, in such a case it is called 'captive user facility' or 'Facility having captive consumption'. Most common example of this is captive power plants generally used in big industries.

The Government generally represented through a ministry or a Government body is a very important member of any infrastructure project being undertaken by even a private entity. In most infrastructure sectors the Government is already an incumbent/existing service provider and is also the authority vesting the rights, and determining the terms and conditions of development of a project by the sponsor and hence their role becomes very vital.

The State Support Agreement is part of many agreements signed by the developer or sponsor. The developer fundamentally seeks to ensure that Government does not intend to take any step, which would make the project less useful and thus causing loss to the developer and the lenders. E.g. take a case of a developer who after due license completed his project (a 26 Km long road) and now he is charging toll on it. Then, if the govt. decides to lay another road which; can be used as a substitute to the toll road without paying any money then the mammoth investment (both public money and the investors equity) made would be rendered useless.

State support also becomes essential for the purposes of providing guarantees and indemnity to the lenders, which makes the project more safe for the lenders. Government at times also issues guarantees to promote certain economic enterprises for reducing the credit risk for investors especially in those activities or areas where the nature

of investment is characterised by long gestation period. These guarantees do not form part of debt. They come into the picture only in the eventuality of default.

The other important participant in any infrastructure project is the regulating authorities. The body vested with the authority and power to regulate the development and provision of the related infrastructure sector are called the Regulators. The examples of infrastructure regulatory bodies in India are Telecommunications Regulatory Authority of India (TRAI), Electricity Regulatory commissions, etc.

The Airport Authority of India (AAI), The National Highway Authority of India (NHAI), Port Trust authorities are some of the other authorities which, though are arm of Government but are also vested with powers to regulate, develop, and maintain their specific area, subject to the legislation granting them the authority.

The authorities like the Pollution Control Board (PCB) and similar bodies are also significant participants and regulators. The Environment Impact Assessment (EIA) of the project is a must, if it is a power project or any other structure, which is likely to cause some discharge or require deforestation or submergence, then different other agencies also come into picture.

#### How a project is undertaken and what are the different stages?

Generally the undermentioned are the documents executed for implementing an Infrastructure project with private participation:

1. The agreement between the project vehicle and the lenders for providing the loan facility for the development of the project.
2. The agreement between the project vehicle and the lenders providing for the security for the loan advanced by the lenders to the project vehicle.
3. The agreement between the sponsor and investors of the project with the lenders, assuring long term participation of the parties in the development of the project.
4. Agreement between the lenders, the project vehicle and the Government authority granting rights in relation to the project.
5. Agreement between all the lenders of the project vehicle.
6. Substitution and/or Step in agreement.

These documents lay down the various stages of the project and what would be the rights and obligations of the parties in these stages thus it is very important to take a quick view of the different stages in implementation of an infrastructure project:

- I. The gestation stage
- II. The development stage
- III. The construction and start-up stage
- IV. The operational and maintenance stage
- V. The termination stage

#### What, where and how much is the risk at each stage?

The risk associated with each project is peculiar to the project only. It is not possible to stipulate the precise risks that a project would face, even if it is in same sector and region as another project. Thus their identification and their management has to be project specific.

Generally, at each stage of implementation of the project certain general risks are always associated.

The process of identification of risk involves the accurate identification and evaluation of various variables that have the potential to adversely affect the implementation of the project or the interests of participant

as the case may be. The correct and accurate identification of risks associated with a specific project is critical to its successful development, implementation and subsequent financing. Risks differ from the interest being sought to be protected. There are risks that affect the project in general. There are certain risks that are perceived only by the project sponsor, or the project contractor, or the government; or the customers or consumers, while certain others may be perceived only by the lenders. The general questions that need to be asked in every project are:

1. Where are the uncertainties associated with the project coming from? What would be their causative factors?
2. What can be done about the causative factors? What are the measures that can be taken to counter or contain or mitigate the risks or its causative factors? Which party is in the best position to undertake the measures so required?
3. What can go wrong with the measures taken to counter or mitigate the risks or its causative factors.

Each stage in the implementation of a project has the risk associated with it that are generally peculiar to that stage of implementation. There are very few that remain unchanged throughout the life of a project.

#### How an infrastructure project is generally financed?

Any infrastructure finance operation begins with the equity investment of the promoter. The critical element in the financing of an infrastructure project is the provision of loan facilities to help finance the implementation of the project.

The financing of infrastructure projects is generally sought to be done through an approach termed as 'Project Finance'.

Project finance transactions, particularly in the infrastructure sector, are typically characterised by long tenure financing<sup>1</sup>. 'Project Finance' can be defined as the method of financing of the development or implementation of any project where lenders look at the project for recovery of amounts due to them rather than at the borrower or the assets of the borrower. Project finance is a method employed by corporations to raise capital on a limited or non-recourse basis<sup>2</sup>.

'Project Finance' has been defined as the form of financing where bulk of financing is repaid principally out of the revenues produced by the concerned project<sup>3</sup>. Since the lenders look towards the successful generation of revenues by the project in order to recover their money, the risk profile of the investment changes drastically along with the interests that needs to be protected.

In **Cash Flow Financing**, the lender estimates the cash flows of a project over its lifetime to see what kind of debt burdens it can support and at what rates. Then the amount of debt, financing rate and the way of repayments can be tailored accordingly to fit the cash flows of the project<sup>4</sup>.

The salient features of project finance are as follows:

1. The lenders finance the project looking at the creditworthiness of

<sup>1</sup> <http://www.projectsmonitor.com/detailnews.asp?newsid=8372> visited on 24-06-05

<sup>2</sup> [www.hsbc.net.com](http://www.hsbc.net.com) Visited on 27-06-2005

<sup>3</sup> Graham Vinter, *Project Finance: A Legal Guide*, 2<sup>nd</sup> edition, Sweet & Maxwell, London, 1998

<sup>4</sup> *Core Financing - Legal Strategies*: [murtiandmurti.com](http://murtiandmurti.com) Visited on 24-06-2005

the project, not the creditworthiness of the borrowing party. The repayment of the loans is made from the earnings of the project.

2. Project financing is also known as “limited recourse” financing as the borrower has a limited liability. The security taken by the lenders is largely confined to the project assets.

Most project finance structures are complex. The risks in the project are spread between the various parties; each risk is usually assumed by the party, which can most efficiently and cost-effectively control or handle it.

Since the basis of project finance is the project itself it is important to understand the revenue streams of the project. Generally the possible money streams into the project are:

- i. Equity investment of the sponsor and the investors of the project
- ii. Quasi equity investment (Preference share investment, investment in hybrid instruments e.g. convertible debentures)
- iii. Debenture/ bonds
- iv. Securitised instruments
- v. Loans (long term as well as short term)
- vi. Revenue from the project (tolls/ tariff payment)
- vii. Insurance proceeds
- viii. Encashment of contractor guarantees

Generally the possible expenditures from the funds for the infrastructure projects are as follows:

- i. Development costs
- ii. Construction costs
- iii. Capitalised interests
- iv. O&M costs
- v. Government dues and taxes
- vi. Loan repayment
- vii. Redemption of bonds/ debentures/ securitised instruments/ quasi equity
- viii. Interest and dividend payment
- ix. Enforcement of any guarantee given by the company.

The lenders identify each main category of possible money outflow and inflow and regulate the same in their finance documents. This is generally done through the mechanism of specifying the manner in which the money flowing in to the project would be utilised (called at times as ‘the cash waterfall’). In order to ensure that that loan is provided only when the basic requirement for enabling the due implementation of the project are in place the right of Project Company to draw down amounts from the facility is made conditional upon the satisfaction of specified criteria. Generally they are (a) obtaining of all required sanctions for the project; (b) the project has not been abandoned; (c) there has not been any default in the project documents or the financing document.

The management of the ‘cash waterfall’ is usually done by opening special purpose accounts for each revenue source, which would have a corresponding special purpose accounts for an expenditure. Money would then flow in from the accounts of the revenue sources, and be allocated to meet the various expenditures, in priority, through the various accounts for each expenditure from which money would be withdrawn only for the purpose of meeting that specific expense. The opening, operation and closing of these various accounts to mane the ‘cash waterfall’ is usually specified in a specific agreement

known as the ‘**trust and retention account** agreement’ or the ‘retention account agreement’. This is a tripartite agreement between the lenders, sponsor and the bank where this account is being opened.

All the monies deposited in such accounts are always placed in trust for the senior lenders and the Project Company in accordance with the terms of the agreement establishing the said account.

The trust and retention account system is usually operated through the written instruction being given by the financial officer of the Project Company after obtaining approval of the concerned agent appointed by the lenders.

Usually sub-accounts are opened with respect to all revenue sources mentioned above and are streamed into the sub-accounts of expenditure in order of priority mentioned above.

The lenders also provide for the priority in which the revenues of the Project Company would be utilised. This is usually dependent upon the project and the requirement of the lenders.

When the project starts generating revenue it becomes very important that the monies are properly channelled. As the monies generated from the project are the only source by which the lenders can expect to get their monies back, it becomes all the more important to regulate the monies generated. It is for this purpose that an Escrow account is opened.

**An Escrow Account refers** to assets or revenue streams held in safe custody, as safety against a contingent situation of non-fulfilment of a contract. In simpler words we may say that an escrow a/c is a third party arrangement to ensure performance of certain obligations between certain parties and operated in terms of an underlying agreement. The account will hold current a/c without cheque drawing facility or a Fixed Deposit account, as defined in the terms of the agreement.

Escrow a/c’s are typically used for lending arrangements, project financing, securitisations, M&A’s, buy-back of shares, take-overs, & sale of land. The following **reasons** enumerate why Escrow accounts are opened:

- ◆ Provides greater security & comfort
- ◆ Trapping of identified cash flows
- ◆ Regulatory requirements
- ◆ Custody of cash/documents
- ◆ Ease of monitoring

The funds in the Escrow a/c are held for the benefit of the Beneficiary of the a/c rather than person / company in whose name the a/c is opened. For example, In a borrower lender arrangement, the a/c name is “Borrower - Escrow a/c” and the funds deposited are that of the borrower but the funds are **held in the escrow a/c for the benefit of the Lender**. In ‘Limited recourse financing’, the importance of escrow account increases due to the fact that the primary security is the project receivables/cash-flows. A project may generate sufficient cash flows to repay its debt; however, sponsors could divert these flows to serve other purposes within or outside the project to the detriment of the lenders. Therefore, establishment of an escrow account is essential for ensuring that the project’s free cash flows are used first of all for debt service or other pre-agreed expenses. An escrow account not only ensures that contract obligations are met. but also help control project expenditures. Therefore, banks/FT’s are encouraged to institute a mechanism for repayment of project debts through an escrow account, which shall

preferably be pledged by the Project Company in favour of lenders for improving the project's overall security package<sup>5</sup>.

The escrow account established by a broker under the provisions of the license law for the purpose of holding funds on behalf of the broker's principal or some other person until the consummation or termination of a transaction<sup>6</sup>.

#### When can the banks Finance and on what terms?

Banks/ FI's are free to finance technically feasible, financially viable and bankable projects undertaken by both public sector and private sector undertaking subject to certain conditions laid down<sup>7</sup>. The restrictions imposed by RBI are a part of prudent strategy to curb fraudulent and wasteful use of public money.

Infrastructure projects are often financed through SPV or Project Vehicle. The lenders look at the project being implemented for ensuring the returns of their loan and the amounts payable under the financing agreement<sup>8</sup>. Thus, Cash Financing calls for specific/appraisal skills on part of lending agencies. Identification of various project risk, evaluation of risk mitigation through appraisal of project contracts and evaluation of creditworthiness of the contracting entities and their abilities to fulfil contractual obligations are an integral part of the appraisal exercise. Individual components of financing and returns on the project are well defined and assessed. State government guarantees may not be taken as a substitute for credit appraisal.

The lender can sanction an amount, which is within the overall ceiling of prudential exposure norms (40% of the bank's capital funds<sup>9</sup> exceedable additional 10% for a group and 15% exceedable by 5% to an individual borrower in certain cases) prescribed by the RBI for infrastructure financing. The banks are under an obligation to verify the bankability and feasibility of the project. Thus they are required to have enough expertise to appraise the project both technically and financially with particular reference to risk analysis and sensitivity analysis.<sup>10</sup>

In case of a project undertaken by the public sector unit, term loans can be sanctioned to only corporate entities. These loans cannot be substitute to budgetary resources; they can only supplement the budgetary resources if such supplementing was contemplated in the project design. The banks have to ensure that these loans are not used for financing the budget of the state government. The lender has to ensure that the revenue stream is sufficient to repay the debt and it (debt) is not re-paid for from the budgetary resources.<sup>11</sup>

Banks are also authorised to lend to SPV's in private sectors, which is directly undertaking infrastructure projects (which are financially viable off-course) and not acting as mere financial intermediaries. The banks should ensure that bankruptcy or financial difficulties of the sponsor does not affect the financial health of the SPV<sup>12</sup>.

<sup>5</sup> *Guidelines for Infrastructure Project Financing (IPF): Banking Policy Department: State Bank of Pakistan: [http://www.safir.teri.res.in/draft\\_guidelines.pdf](http://www.safir.teri.res.in/draft_guidelines.pdf) Visited on 27-06-2005*

<sup>6</sup> [http://www.4554.com/Glossary/ESCROW\\_ACCOUNT.html](http://www.4554.com/Glossary/ESCROW_ACCOUNT.html) visited on 27-06-2005

<sup>7</sup> *Guidelines for Financing of Infrastructure Projects: DBOD.NO BP.BC. 67/21.04.048/2002-2003 Dated February 4, 2003*

<sup>8</sup> *Piyush Joshi: Law Relating to Infrastructure Projects, 2<sup>nd</sup> Ed Lexis Butterworths, New Delhi, 2003*

<sup>9</sup> *Bank's Capital Funds = Paid up Capital + Free Reserves*

<sup>10</sup> *Guidelines for Financing of Infrastructure Projects: DBOD. No BP. BC. 67/21.04.048/2002-2003 Dated February 4, 2003*

<sup>11</sup> *Guidelines for Financing of Infrastructure Projects: DBOD. No BP. BC. 67/21.04.048/2002-2003 Dated February 4, 2003*

<sup>12</sup> *Guidelines for Financing of Infrastructure Projects: DBOD. No BP. BC. 67/21.04.048/2002-2003 Dated February 4, 2003*

The lenders have been advised that promoter's contribution of his equity (in the project vehicle) should come from his own resources and banks should not lend to raise such equity. However, the RBI has also said that in certain cases an exception may be created for this rule.<sup>13</sup> In such cases the sponsor should have sufficient and satisfactory net worth and should not have been a defaulter under similar conditions suggesting that the chances of default in payment are very low if not totally absent. The risk of increased leverage is mitigated by the existing cash flows of the company that have been collateralised to provide security for the project<sup>14</sup>.

Generally Infrastructure funding requires large amounts and is generally not possible for a single bank to undertake. Thus a consortium of banks finances the project. In such case RBI has proposed that as timely finance is most important requirement for timely completion of the project (thus reducing the chances of cost escalations) multiple appraisals, should be avoided and banks may rely or lead bank's (which is the main lender to the project) appraisal report. It also is the responsibility of the lender to ensure that loan amount is utilised for the purpose it had been sanctioned for. Thus lenders have been advised by RBI to undertake projects, which can be specifically monitored.

#### What are the securities generally accepted by lenders?

Infrastructure financing being highly capital intensive often does not permit the possibility of a security structure that allows lenders full recourse to the assets of the promoters. Hence, a 'non-recourse' or 'limited recourse' arrangement is more likely to be adopted, involving the creation of a legally independent project company financed with debt that is secured by the assets of that company (e.g. land, industrial assets, licenses, and contractual rights). In India, the immovable assets (e.g. land, machinery, buildings) of the project company are usually secured in favour of the lender by way of a mortgage while the movable assets are 'hypothecated'.

In the project finance transaction the debt financing facilities extended to infrastructure projects is to ensure that adequate right, title and interest is created in favour of the lenders over each aspect of the concerned project. This is to enable the lenders to have complete recourse to the project for recovery of the amounts due.

This purpose would only be satisfied if enforceable security interest is created in favour of the lenders in relation to:

- a) All the physical immovable assets of the project;
- b) All the physical movable assets of the project;
- c) All revenues streams of the project;
- d) All right of the project company under the main project contracts that are essential to ensure the due implementation of the project;
- e) The majority shareholding in the project vehicle (company).
- f) All the intangible assets of the project;
- g) All the security and rights vested with the project company for securing the due payment by the main consumer/user of the project.

All these can serve as security since the project vehicle and the promoter never actually want to pledge or mortgage anything more than their interest in the project and the proceeds there from.

<sup>13</sup> *Guidelines for Financing of Infrastructure Projects: DBOD. No BP. BC. 67/21.04.048/2002-2003 Dated February 4, 2003*

<sup>14</sup> <http://www.projectsmonitor.com/detailnews.asp?newsid=8372> visited on 24-06-05

Thus the following security interest can be created in favour of the lender:

1. Mortgage of all immovable physical assets related to the project.
2. Pledge, hypothecation or charge on all movables in the project.
3. Assignment of all revenue stream by creating an escrow account and trust and retention mechanism.
4. Pledge of the equity of the sponsor and investor with the lender.
5. Assignment of all intangible assets of the project vehicle.
6. Assignment of all rights titles and interest in the project in favour of the lenders.

As is the case always the developer acquires certain rights over the area on which he is developing the project through the government concession. Thus in most cases the developer does not have the authority or sufficient rights over the physical immovable assets to mortgage it. In all such cases the most effective traditional security created is the pledge of promoters equity and assignments of all rights and interest over the project

The traditional securities<sup>15</sup>; created in respect of project assets of an infrastructure project are more with the aim of ensuring that no third party obtains a right, interest or claim in relation to the project assets. They are not created with the aim of actually looking at the project assets themselves for recovery of amount due. The enforcement of the traditional security over the project assets would generally be the very last recourse of the lenders, and the lenders would not be able to recover the entire exposure by the enforcement of the security against the project assets alone. This is because in infrastructure project the project assets (both moveable and immovable), without a functioning project, do not have any value as those of functioning projects. For example, the road independent of a functioning project has, as such, no market value. Obtaining security interest over the land, right of way and the road is essentially to ensure no third party can claim a right to it, rather than as a means of recovering the amounts due. Even in projects like a power plant, though the assets have some independent value it is by no means equivalent to that of a functioning project.

In infrastructure financing FI's are in slightly better and secure position as compared to banks. RBI (does not allow the credit risk and finance to be separated for the bank i.e. banks cannot obtain a corresponding bank guarantee from any other bank covering the default situation of the sponsor. However this restriction does not apply to FI's. In respect of infrastructure projects, banks would be permitted to issue guarantees favouring other lending institutions provided the bank issuing the guarantee takes a funded share in the project, at least to the extent of 5 per cent of the project cost and undertakes normal credit appraisal, monitoring and follow up of the project.

The process of enforcement of security depends upon the nature of security being sought to be enforced. If the security is in the nature of a guarantee or deposit of money, or a pledge of movables, then enforcement is more in the nature of action undertaken by the secured creditor under the concerned contract that created the security. However, if the security is that of an interest in immovable property

<sup>15</sup> The term 'traditional security' is being used signify the usual security granted in the case of a loan, namely, mortgage over the immovable property, hypothecation/charge over the moveable assets, pledge of share and the like.

or an interest that has been created and regulated under specific provision of law rather than contract, then the enforcement of security would be dependent upon and regulated by the provisions of the concerned laws.

In relation to project finance transaction, the main security being created in favour of the lenders is essentially the rights in relation to the project as a whole. The various individual securities that are created in favour of the lenders are essentially the rights in relation to the project as a whole. These securities are essentially the project itself. It is in the ability to support the enforcement of the right to ensure the continued operation of the project and consequently the ability of the project to generate revenues which helps debt to be repaid. However the current legal framework is tuned in the structure to enable a lender to recover the monies due to him. It does not focus on ensuring smooth running of a project, which would generate sufficient revenue for repayment of debt. Thus the provision of Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002; allowing take-over of management<sup>16</sup> of the securitized assets is thus an enabling provision and helps the lenders more than any other provision allowing recovery of the debt.

The most feasible security that can be created in favour of the lenders financing an infrastructure project is the security over the continued implementation of the project upon the occurrence of event of default by the Project Company.

#### **Rights and obligations of lenders and borrower in case of default in payment of loan amount by the sponsor.**

In financing an infrastructure project, the lenders look at the project being implemented for ensuring the return of their loan and the amounts payable under the financing documents. Consequently, the emphasis of security creation in relation to financing of infrastructure project is to ensure that, in event of default by the Project Company, the lenders can look towards ensuring the implementation of the project so as to provide for the repayment of their dues.

To adequately secure the continued implementation of infrastructure project, rights are created in favour of the lenders with respect to each aspects of implementation of the project. The main problem faced by the lenders in obtaining adequate rights with respect to all these aspects of the implementation of the project is that they are all covered by specific contracts of concessions and permissions. The lenders have no direct rights with respect to different aspect of the project. The way to create such enforceable interest in the implementation of the entire project would be to provide privity to the critical contracts that secure the implementation of the project. This is done through the execution of what are generally known as 'direct agreements'.

The mechanism that most direct agreements provide for is the ability of the lenders to step in and substitute the defaulting Project Company (borrower), and instead provide for a new entity that would continue to implement the project. This mechanism has to be coupled with a clear acknowledgement of the security interest of the lenders and restriction on the rights of other parties to terminate the concerned contracts upon the occurrence of an event of default by the Project Company. □

<sup>16</sup> Section 13(4) of Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

# Derivatives: The powerful tools for Risk Management

Dr. S.Z.H. Zaidi

## Introduction

Derivatives have changed the face of finance by creating new ways to understand, measure and manage financial risks. Derivatives offer organizations the opportunity to break financial risks into smaller components and then to buy and sell those components to best meet specific risk management objectives. Usually derivatives should be considered as a part of any organisation's risk management to ensure that value enhancing investment opportunities can be pursued.

**Derivatives:** Derivatives are financial assets whose price depends on the price of other financial assets called underlying. Properly used and understood derivatives are a powerful tool for managing risk. However, using derivatives to manage risk is like using a chain saw to cut down trees. The chain saw is more effective than a hand saw but it is also more dangerous.

Derivatives offer various benefits such as risk management and efficiency in trading etc., to its users. Financial derivatives should be included in any organisation's risk control arsenal.

The purpose of this paper is to outline the importance of derivatives within a risk management environment. As the title implies, two main aspects will be addressed in this article, i.e., the concept of derivatives and their use for effective risk management.

An attempt has been made here to explain derivative instruments and their application to corporate strategy and risk management. A distinction has also been made between using derivatives to appropriately manage risk and using them for speculation. It is also emphasised that derivative instruments are problem solving tools that, when used correctly, can create value for financial and Non-financial Corporations.

## Emergence of financial derivative products

Derivative products initially emerged as hedging devices against fluctuations in commodity prices, and commodity linked derivatives remained the sole form of such products for almost three hundred years. Financial derivatives came into spotlight in the post-1970 period due to growing instability in the financial markets. However, since their emergence, these products have become very popular and by 1990s, they accounted for about two-thirds of total transactions in derivative products. In recent years, the market for financial derivatives has grown tremendously in terms of variety of instruments available, their complexity and also turnover. In the class of equity derivatives the world over, futures and options on stock indices have gained more popularity than on individual stocks, especially among institutional investors, who are major users of index-linked derivatives. Even small investors find them useful due to high correlation of the popular indexes with various portfolios and ease of use. The lower costs associated with index derivatives vis-à-vis derivative products based on individual securities is another reason for their growing use. (Source:www.nseindia.com)

## The need for a derivatives market

The derivatives market performs a number of economic functions for instance:

1. They help in transferring risks from risk averse people to risk oriented people.
2. They help in discovery of future as well as current prices.
3. They catalyze entrepreneurial activity.
4. They increase the volume traded in markets because of participation of risk averse people in greater numbers.
5. They increase savings and investment in the long run.

## The participants in a derivatives market

There are a number of players in derivatives market like,

- ◆ **Hedgers** use futures or options markets to reduce or eliminate the risk associated with price of an asset.

The hedgers may either follow a passive strategy or an active strategy to cover the risks. Passive strategy refers to the situation whereby the hedger does not want to take the risk and hence would cover the entire portfolio of risk. On the contrary, in active strategy he covers only a part of portfolio of Risk and leaves some of the risk uncovered in the hope of getting higher returns.

- ◆ **Speculators** use futures and options contracts to get extra leverage in betting on future movements in the price of an asset. They can increase both the potential gains and losses by usage of derivatives in a speculative venture.
- ◆ **Arbitrageurs** are in business to take advantage of a discrepancy between prices in two different markets. If, for example, they see the futures price of an asset getting out of line with the cash price, they will take offsetting positions in the two markets to lock in a profit.

## Types of Derivatives

**Forwards:** A forward contract is a customized contract between two entities, where settlement takes place on a specific date in the future at pre-agreed price to buy or sell an asset.

Example: In the month of February, a flour mill agrees to buy one tonne of wheat from a farmer in the following April at a price of Rs.12,000 per tonne. This is a forward contract. Wherein the farmer will receive Rs.12,000 in April irrespective of whether the market price in April is Rs.10,000 or Rs.13,000 and give delivery to the flour mill. Thus the contract has locked the price of wheat both for the farmer as well as the flour mill irrespective of market fluctuations. This avoids risk and ensure stability.

**Futures:** A futures contract is an agreement between two parties to buy or sell an asset at a certain time in the future at a certain price. Futures contracts are standardized exchange-traded contracts.

**Example:** If Satyam Computer is trading at, say Rs.300 in exchange on 1<sup>st</sup> April, 2006. Satyam April future is normally priced above Rs.300 (Say Rs.303) since the time for settlement in future fall on last Thursday of April, 2006, i.e., 27<sup>th</sup> April. The difference between spot price (Rs.300) and future i.e. (Rs.303) is called 'basis' and this is mainly the cost of funds for the period from 1<sup>st</sup> April, 2006, to 27<sup>th</sup> April, 2006. On the day of expiry all future contracts are automatically

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squared off at the closing rate of stock, meaning that the 'basis' comes to zero at that time.

For many companies, the wide fluctuations in interest rates and Foreign exchange rates have become at least as important a source of risk as changes in 'Commodity prices.' Financial futures are similar to commodity futures, but instead of placing an order to buy or sell a commodity at a future date, you place an order to buy or sell a financial asset at a future date.

Financial futures have been a remarkably successful innovation. They were invented in 1972; within a few years, trading in financial futures significantly exceeded trading in commodity futures.

**Option:** Options are of two types – calls and puts. Calls give the buyer the right but not the obligation to buy a given quantity of the underlying asset, at a given price on or before a given future date. Puts give the buyer the right, but not the obligation to sell a given quantity of the underlying asset at a given price on or before a given date.

Option may be of American style and European style. In American style, the holder of option can exercise his right any time on or before the maturity date. However, in the case of European style the option can be exercised on the date of maturity only.

**Warrants:** Options generally have lives of upto one year. However, the majority of options traded in India on options exchanges are having a maturity of 1, 2 and 3 months. Longer-dated options are called warrants and are generally traded over-the-counter.

**LEAPS:** The LEAPS stands for Long-Term Equity Anticipation Securities.

LEAPS are option contracts that can last as long as two years. Normal options tend to last no longer than nine months.

LEAPS are an excellent way, if not the only way, to make a long term option investment. They trade like normal options but allow investors to benefit from the appreciation of equities while placing a lot less money at risk than is required to purchase the stock

**Baskets:** Basket options are options on portfolios of underlying assets. The underlying asset is usually a moving average or a basket of assets. Equity index options are a form of basket options.

**Swaps:** Swaps are private agreements between two parties to exchange cash flows in the future according to a prearranged formula. They can be regarded as portfolios of forward contracts. The two commonly used swaps are:

◆ **Interest rate swaps:** These entail swapping only the interest related cash flows between the parties in the same currency.

The estimated volume in the Interest rate swap market has gone up to Rs.525.053 crores during the eight months from April, 2006 from about Rs. 4,50,000 crores in 2005-06. (Source: Business line, November 12, 2006)

◆ **Currency swaps:** These entail swapping both principal and interest cash flows between the parties in two different currencies.

**Swaptions:** Swaptions are options to buy or sell a swap that will become operative at the expiry of the options. Thus, a swaption is an option on a forward swap. Rather than have calls and puts, the swaptions market has receiver swaptions and payer swaptions. A receiver swaption is an option to receive fixed and pay floating. A payer swaption is an option to pay fixed and receive floating.

## Exchange Traded vs. Over-The-Counter (OTC) Derivatives

There are two main forums within which derivatives trade – organized exchanges and over-the-counter (OTC). They are similar in many respects, but do have important distinguishing features as illustrated in the table 1.

The OTC derivatives have witnessed rather sharp growth over the last few years, which is owing to the modernization of commercial and investment banking and globalization of financial activities. The innovations in information technology and better communication facilities have contributed to a great extent to these developments. While both exchange-traded and OTC derivative contracts offer many benefits, the former have rigid structures compared to the latter.

The OTC derivatives markets have other following features compared to exchange-traded derivatives:

1. The management of counter-party (credit) risk is decentralized and located within individual institutions;
2. There are no formal centralized limits on individual positions, leverage, or margining;
3. There are no formal rules for risk and burden-sharing;
4. There are no formal rules or mechanisms for ensuring market stability and integrity, and for safeguarding the collective interest of market participants; and
5. The OTC contracts are generally not regulated by a regulatory authority. Although they are affected indirectly by national legal systems, banking supervision and market surveillance.

The OTC derivatives market is huge. According to the Bank for International Settlements the total outstanding notional amount is USD 298 trillion (as of 2005).

TABLE - 1

FEATURES	Over-The-Counter	Exchange Traded
<b>Examples</b>	Forwards, Caps, Floors, Collars, Swaps, etc.	Futures and Options.
<b>Market</b>	Networks consisting of market makers who exchange price information and negotiate transactions.	Organized exchanges like NSE, BSE and other exchanges in capital markets around the world like Chicago, New York, Kansas City and others etc..
<b>Agreements</b>	Custom-tailored to meet specific needs to counter-parties within accepted guidelines.	Standardized contracts.
<b>Risk</b>	Default/credit risk to the counter-parties.	Guaranteed contract performance.
<b>Regulation</b>	Not formally regulated	Regulated by SEBI guidelines in India. U.S. exchanges regulated by Commodity Futures Trading Commission (CFTC).
<b>Ability to Value</b>	Varies by market – some have electronic posting, others require individual inquiry and valuation.	Daily settlement and intra-day prices electronically posted.

According to BIS the Combined turnover in the world's derivatives exchanges totaled USD 344 trillion in 2005 (4<sup>th</sup> Quarter).

**Factors driving the growth of financial derivatives**

1. Increased volatility in asset prices in financial markets;
2. Increased integration of national financial markets with the international markets;
3. Marked improvement in communication facilities and sharp decline in their costs;
4. Development of more sophisticated risk management tools, providing economic agents a wider choice of risk management strategies; and
5. Innovations in the derivatives markets, which optimally combine the risks and returns over a large number of financial assets leading to higher returns, reduced risk as well as transactions costs as compared to individual financial assets.

In India, derivatives for one, two and three months duration are in vogue. All derivatives expire on the last Thursday of the respective month's.

The use of derivatives has expanded phenomenally over the last few years. These instruments have gained considerable importance and are growing in popularity. One of the main reasons for this dynamic growth of derivatives is the necessity of investors to hedge against adverse price movements. Markets turned much more volatile following the liberalization and deregulation of economy which in turn spurred a more sophisticated derivatives market.

Tables-2 and 3 provides a glimpse of various financial derivatives products traded at National Stock Exchange of India (NSE) and their phenomenal growth in recent times:

**Derivatives at BSE:** The Bombay Stock Exchange (BSE) created history on June 9, 2000 by launching the first Exchange Traded Index Derivative Contract i.e., futures on the capital market benchmark index – the BSE Sensex. The first historical trade of 5 contracts of June series was done at the rate of 4755.

In the sequence of product innovation, the exchange commenced trading in Index Options on Sensex on June 1, 2001. Stock options were introduced on 31 stocks on July 9, 2001 and single stock futures were launched on November 9, 2002.

**TABLE - 2**

<b>Products</b>	<b>Index Futures</b>	<b>Index Options</b>	<b>Futures on Individual Securities</b>	<b>Options on Individual Securities</b>
Underlying stipulated	S&P CNX Nifty	S&P CNX Nifty	30 Securities stipulated Instrument by SEBI	30 securities stipulated Instrument by SEBI
Type		European		American
Trading Cycle	Maximum of 3-months trading cycle. At any point of time, there will be 3 contracts available: 1) near month, 2) mid month & 3) far month duration	Same as index futures	Same as index futures	Same as index futures
Expiry Day	Last Thursday of the expiry month	Same as index futures	Same as index futures	Same as index futures
Contract Size	Permitted lot size is 200 & multiples thereof	Same as index futures	As stipulated by NSE (not less than Rs.2 lacs)	As stipulated by NSE (not less than Rs.2 lacs)
Price Steps	Re.0.05	Re.0.05		
Base Price-First day of trading	Previous day closing Nifty value	Theoretical value of the options contract arrived at based on Black-Scholes model	Previous day closing value of underlying security.	Same as Index options.
Base Price-Subsequent	Daily settlement price	Daily close price	Daily settlement price	Same as Index options
Price Bands	Operating ranges are kept at +10%	Operating ranges are kept at 99% of the base price	Operating ranges are kept at +20%	Operating ranges are kept at 99% of the base price.
Quantity Freeze	20,000 units or greater	20,000 units or greater	Lower of 1% of market wide position limit stipulated for open positions or Rs.5 crores	Same as individual futures.

September 13, 2004 marked another milestone in the history of Indian Capital Markets, the day on which the Bombay Stock Exchange launched Weekly Options, a unique product unparalleled in derivatives markets, both domestic and international. BSE permitted trading in weekly contracts in options in the shares of four leading companies namely Reliance, Satyam, State Bank of India and Tisco in addition to the flagship index-Sensex.

Equity Futures & Options were introduced in India having a maximum life of 3 months. These options expire on the last Thursday of the expiring month. There was a need felt in the market for options of shorter maturity. To cater to this need of the market participants BSE launched weekly options on 4 stocks and the BSE Sensex.

Weekly options have the same characteristics as that of the Monthly Stock Options (stocks and indices) except that these options settle on Friday of every week. These options are introduced on Monday of every week and have a maturity of 2 weeks, expiring on Friday of the expiring week.

#### Types of Products

- ◆ Index Futures
- ◆ Index Options
- ◆ Stock Futures
- ◆ Stock Options
- ◆ Weekly Options

**Trading System:** The Derivatives Trading at BSE takes place through a fully automated screen based trading platform called as DTSS (Derivatives Trading and Settlement System). The DTSS is designed to allow trading on a real time basis. In addition to generating trades by matching opposite orders, the DTSS also generates various reports for the member participants.

#### Commodity Derivatives in India

At present there are three commodity exchanges in India namely National Multi-Commodity Exchange of India Ltd. (NMCE), Ahmedabad, National Commodity and Derivatives Exchange of India Ltd. (NCDEX) at Mumbai and Multi-Commodity Exchange (MCX) also at Mumbai.

The country's commodity exchanges have modern infrastructure, complete with up-to-date technology. There are over 5000 members, covering more than 1000 centres. Volumes which had stood at

about Rs.20,000 crores in 2000-01, have increased roughly 100 times in the past four years.

Futures contracts in pepper, turmeric, gur (jaggery), Hessian (jute fabric), jute sacking, castor seed, potato, coffee, cotton, and soyabean and its derivatives are traded in commodity exchanges located in various parts of the country. Futures trading in edible oils, oilseeds and oil cakes have been permitted. The policy initiatives and the modernization programme include extensive training, structuring a reliable clearinghouse, establishment of a system of warehouse receipts, and the thrust towards the establishment of more national commodity exchanges. With commodity futures, delivery is best effected using warehouse receipts (which are like dematerialized securities). Warehousing functions have enabled viable exchanges to augment their strengths in contract design and trading. The Coffee Futures Exchange of India (COFEI) has operated a system of warehouse receipts since 1998).

Currently over 70 Commodities including gold and silver, are traded in these exchanges and as the list of items grows in future the size of commodity marketing will naturally broaden further.

It is recommended that government allows banks and FIIs' to enter into the commodity futures market with uniform transaction charges for all Commodities. These measures, if implemented in letter and spirit will undoubtedly transform the commodity exchanges as they will not only enhance depth but would also increase the liquidity of the market. Besides these, educating and creating awareness among the participants would also be a major reforms.

Trading in futures offers many advantages such as, hedging, price-risk management, balanced supply demand situations, facilitating production and manufacturing activities, they can especially be of great help to farmers. It will help them in price discovery since they can make an informed decision on future expected prices.

Not only farmers, but a large number of raw-material intensive industries such as agro-processors, auto ancillaries, chemicals, textiles, and steel, benefit by trading in future, since they are able to hedge forward both their input costs and final product prices.

The Forward Market Commission (FMC) expects a number of major developments to unfold in near future. These will spawn from the introduction of indices, arrival of new players (like Mutual Funds) and foreign Institutional Investors.

#### Why Use Derivatives for Risk Management?

There are two main reasons for the use of derivatives for the risk management:

1. High and variable levels of market volatility. These conditions have existed since the mid 1970's.
2. Limited ability to adequately manage risk exposure by just using policy decisions and cash market transactions.

To add value to the shareholders wealth companies need to take risks. But they at the same time try to minimize the financial impacts of risks or avoid those risk that carry no compensation gains. For example, a company engaged in the business of coffee, having substantial fluctuations in the price, tries to minimize the impact of wide fluctuations by fixing the prices of coffee in advance. At the same time, the company also resort to coffee futures and options to reduce even further the risks of sudden price rise.

It is worth mentioning here that no two companies faces the same kind of risks. Some of the companies may be facing interest rate risk, whereas

**TABLE - 3 Records Achieved in the F&O Segment at NSE**

Product	Traded Value (Rs. in crores)	Date
Index Futures	19,586	18-May-06
Stock Futures	38,839	27-April-06
Index Options	4,824	16-May-06
Stock Options	2,306	17-Jan-06
Interest Rate Futures	140	24-Jun-03
Total F&O Traded Value	60,434	27-April-06
Open Interest on Contract Expiry (number of contracts)	15,38,912	30-Mar-06

Source: www.nseindia.com

**TABLE - 4 : Comparative Analysis – World Exchange (September, 2006)**

Product	Stock Futures		Index Futures		Stock Options		Index Options	
NSE's Position	1 <sup>st</sup> with 86,44,137 contracts		4 <sup>th</sup> with 50,81,055 contracts		14 <sup>th</sup> with 5,07,553 contracts		9 <sup>th</sup> with 15,24,721 contracts	
Rank	Name of the Exchange	Number of Contracts	Name of the Exchange	Number of contracts	Name of the Exchange	Number of Contracts	Name of the Exchange	Number of contracts
1	NSE	86,44,137	Chicago Mercantile Exchange	3,92,84,988	CBOE	3,01,00,372	Korea Exchange	17,68,08,791
2.	JSE	79,86,991	Eurex	2,64,13,276	Sao Paulo SE	2,44,46,393	CBOE	2,23,97,040
3.	BME Spanish Exchange	33,55,695	Euronext life	70,50,615	Philadelphia SE	2,07,86,135	Eurex	1,69,63,537

**TABLE - 5 : Top 5 most active Futures Contracts**

S. No.	Contract Description	No. of Contracts	Traded Value (Rs. Crores)	Percentage of Contracts to Total Contracts
1.	NIFTY SEPTEMBER 2006	4,310,608	149904	31
2.	NIFTY OCTOBER 2006	736,093	26170	5
3.	RELIANCE SEPTEMBER 2006	711,194	24301	5
4.	TATASTEEL SEPTEMBER 2006	325,971	11236	2
5.	RELCAPITAL SEPTEMBER 2006	253,657	7291	2
	OTHERS	7,387,669	234045	55
	<b>TOTAL</b>	<b>13,725,192</b>	<b>452,948</b>	<b>100</b>

**TABLE - 6 : Top 5 most active Options contracts**

S. No.	Contract Description	No. of Contracts	Traded Value (Rs. Crores)	Percentage of Contracts to Total Contracts
1.	NIFTY SEPTEMBER 2006 CE 3500	233,955	8,313	12
2.	NIFTY SEPTEMBER 2006 PE 3400	152,101	5,247	7
3.	NIFTY SEPTEMBER 2006 PE 3500	138,280	4,918	7
4.	NIFTY SEPTEMBER 2006 CE 3550	121,001	4,333	6
5.	NIFTY SEPTEMBER 2006 CE 3400	115,824	4,051	6
	OTHERS	1271113	43,136	63
	<b>TOTAL</b>	<b>2,032,274</b>	<b>69,999</b>	<b>100</b>

**TABLE - 7 : Option Exercises – Analysis (Contract Month August 2006)**

Underlying	Option Type		Total No. of contracts exercised	% to Total
	Call	Put		
Nifty	65817	7860	73677	72.52
Others	23672	4253	27925	27.48
<b>Total</b>	<b>89489</b>	<b>12113</b>	<b>101602</b>	<b>100.00</b>

others may be facing foreign exchange rate risk like oil companies. Hence, the individual companies need to formulate their own peculiar strategies to deal with the risk effectively.

It is essential for Financial Managers to identify risks accurately and to use the right techniques for control of risk. This requires orientation with different types of risk, and explanation as to how to use the risk cycle to recognise these risks and control them with derivatives techniques that can be used to manage risk, including FX risks, interest rate risk.

In view of the above, Risk Management has increased in importance and sophistication in recent years. Increased volatility in financial markets across the globe has led to the development of a number of new financial instruments for managing the risks associated with specific transactions.

Risk Management has been defined as the sum of objectives, policies, procedures, processes and actions implemented to define, measure, limit, control, inform and disclose the various forms of risk to stakeholders.

It is also true to say that Risk Management is an ongoing function as opposed to a one time activity

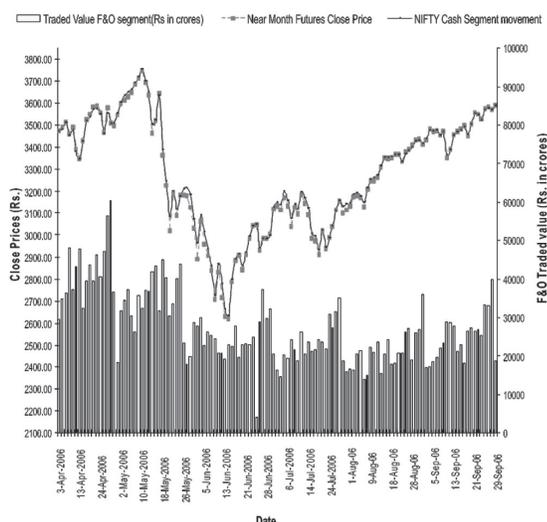
- ◆ Beside this it is also pertinent to say that Risks changes frequently and must therefore be monitored and measured continuously because
  - new risks occurs now and then.
  - Small risks become large ones meriting closer attention and vice versa.

In this background many aspects of hedging tools must be understood with regard to

- Tax, accounting and legal implications.
- Hedge effectiveness.

**Overview of the F&O Segment – April 2006 to September 2006**

Comparison of the close prices of the NIFTY Near Month Futures Contract (F&O Segment) with the underlying movement of the NIFTY Index (Cash Segment), along with the Daily Traded value of the F&O Segment:



The portfolio of risks and hedges must be measured constantly to monitor changes in underlying assumptions and measuring systems must be continuously updated.

Management and regulators should be updated frequently to ensure objectives and limits remain appropriate.

### Sample risks and potential management tools

<b>Sample Risks</b>	<b>Potential Management Tools</b>
Production stoppages from disasters... Drop in value of products sold.....	Insurance Commodity and FX derivatives
Increase in cost of raw materials.....	Commodity and FX derivatives
Drop in value of interest income and investments.....	IR and FX derivatives
Increase in value of interest expense and liabilities	IR and FX derivatives
Drop in value of equity portfolio.....	Equity derivatives
Accidental destruction of fixed assets...	Insurance
Litigation.....	Insurance

### Application of Financial Derivatives in Managing Risk

Some of the benefits that financial derivatives bring to its users may be enumerated as:

**Risk Management:** Risk management is not about the elimination of risk rather it is about the management of risk. Financial derivatives provide a powerful tool for limiting risks that individuals and organizations face in the ordinary conduct of their business. Successful risk management with derivatives requires a thorough understanding of the principles that govern the pricing of financial derivatives. Used correctly, derivatives can save costs and increase returns.

**Trading Efficiency:** Derivatives allow for the free trading of individual risk components, thereby improving market efficiency. Traders can use a position in one or more financial derivatives as a substitute for a position in the underlying instruments. In many instances traders find financial derivatives to be a more attractive instrument than the underlying security. Reason being, the greater amount of liquidity in the market offered by the financial derivatives and lower transaction costs associated with trading a financial derivative as compared to the costs of trading the underlying instrument.

**Speculation:** Serving as a speculative tool is not the only use, and probably not the most important use of financial derivatives. Financial derivatives are considered to be risky. However, these instruments act as a powerful instrument for knowledgeable traders to expose themselves to properly calculated and well understood risks in pursuit of a reward i.e., profit.

Derivatives are used to protect treasury transactions from market risks. Derivatives are also used in managing balancesheet risks, that is, asset liability management.

The functions of financial futures markets are intrinsically no different from those of any other futures markets. They, therefore, include risk-transference, price stabilization, price discovery/registration etc.

In the case of interest rate futures, many financial Institutions like banks, insurance companies and pension funds, acting either as borrowers or as lenders are protected from adverse changes in the value of their assets and liabilities due to changes in interest rates.

With currency futures, exporters/importers and those who borrow and lend in foreign exchange market; banks and all sorts of financial institutions, are protected against exchange rate movements.

Stock market index futures protect large scale market investors from adverse changes in their portfolio value.

Option contracts have a distinct advantage over the forward market or the futures market. This is because, in the forward market, once you lock into a rate through either market, you cannot benefit from a movement of the market in your favour. In other words, once a rate is crystallized, you can not gain from a favourable change in the rate although you are protected from an adverse movement in the rates. However, in the case of option contract, one can take advantage of even a favourable rate movement.

All scheduled commercial banks are allowed now to enter into derivative contract for the limited purpose of hedging their risk in their underlying investment portfolio in a phased manner. Banks are extensively using derivatives to hedge their exposure in secondary markets.

A bank may structure a derivative product to suit the individual client based on its risk appetite, size of transaction and maturity requirement.

### The risk characters of derivatives

An important difference between cash and derivatives is the fact that whereas cash transactions require an upfront payment, derivatives require only part payment.

Derivatives facilitate the transfer of financial risks associated with a given portfolio without selling the portfolio itself. They allow investors to manage their risks and achieve both their desired risk profile and risk allocation more precisely and efficiently than any other instrument. Derivatives are not inherently speculative instruments when used as insurance against uncertainty.

Both the bundling of one or more underlying instruments into one contract and transferring payments into the future are obvious benefits of these instruments. Further, more the improved opportunity to transfer or eliminate various market risks cause the efficiency of derivatives. They provide a risk management tool.

Derivative instruments with their specific risks, fuelled by the increase in market volatility and the growth in their complexity are assuming even more importance. This is reflected in both the increased customer demand for better ways to manage financial risks and the innovative response of the financial service industry to such demand. But substantial losses in connection with the use of derivatives have occurred at such notable and varied companies as Metallgesellschaft, Gibson greeting, Proctor & Gamble, Bankers Trust, Merrill Lynch and 'Barings.

It has been widely discussed that the highly leveraged institutions and their OTC derivative positions were the main cause of turbulence in financial markets in 1998. These episodes of turbulence revealed the risks posed to markets stability originating in features of OTC derivative instruments and markets.

Shaken by evidence of poor risk management and control, regulators are continually reviewing reporting requirements with a view to revealing risk exposure. This development presents both a challenge and an opportunity to banks, financial institutions and corporates to integrate their risk management needs with regulatory requirements. It is understood that the Reserve Bank of India is under the process of framing an "appropriate" policy which will require banks to do due

diligence of their client to find out their capability of taking the risk, before selling derivative products to them.

Individual risk management models in accordance with the Value at Risk (VAR) methodology form the basis to manage financial risks. Bundling underlyings, designing cash flow patterns, unbundling and transferring risks associated with portfolios and creating both the desired risk profile and risk allocation of portfolios are some of the benefits of derivatives in a risk management environment.

However, Derivatives have a darker side also. Without a clearly defined risk management strategy excessive use of financial derivatives can cause serious losses and can threaten the firm's long term objectives. Derivatives being an important risk management tool necessitate its users to understand the intended function and the safety precautions before being put to use for the benefit of the society at large.

In nutshell it may not be out of place to say that

- (i) Managing risk is not speculation.
- (ii) To choose to be unaware of risks and tools like derivatives to manage risk can be costly.
- (iii) Corporates can do more to actively manage risk.
- (iv) Changes in the regulatory framework of Indian banks, insurance companies and pension funds will hopefully make the tools necessary to manage risk more accessible.
- (v) There is need to promote risk management culture.
- (vi) Derivatives are important and powerful tools for risk management. □

# Taxation Laws Amendment Act, 2006: A Guide to Amendments in Indirect Taxes

*Smita Mishra*

The Taxation Laws Amendment Bill has been enacted on 13.07.2006, the date on which it received the assent of the President. It has made certain amendments in the Income-tax Act, 1961, the Central Excise Act, 1944, the Customs Tariff Act, 1975 and the Customs Act, 1962 with the object of rationalizing and simplifying procedures, widening of tax base and plugging loopholes leading to leakage of revenue.

The amendments made in the Central Excise Act, 1944 and the Customs Act, 1962 *inter-alia* provide an optional scheme for settlement of disputes at the earliest and encourage voluntary payment of tax dues. A simplified and time bound customs assessment in case of contrary claims by assessee by issue of speaking order within 15 days of assessment has been introduced to provide certainty and room for appeal. Further, publication of names of tax evaders, provisional attachment of property during the pendency of proceedings have been introduced as measures to curb evasion of customs and central excise duty and to facilitate recovery of amounts due as revenue to the Government. These amendments have been discussed below in detail.

## I. AMENDMENTS IN THE CENTRAL EXCISE ACT, 1944

Certain amendments to section 11A and section 35E of the Central Excise Act, 1944 and rule 16 of the Central Excise Rules, 2002 have been effected vide the Taxation Laws Amendment Act, 2006. Further, two new sections namely, section 11DDA and section 37E have been incorporated in the Central Excise Act, 1944.

### (i) Adjudication proceedings to conclude in respect of a person who voluntarily deposits the full excise duty demanded along with interest and penalty equal to 25% of the excise duty [Section 11A(1A)]

(1) Section 11A(1) provides that where excise duty is short/not levied or short/not paid or erroneously refunded, the Central Excise Officer can issue a show cause notice within 1 year from the relevant date. However, this period of 1 year is extended to 5 years when such short/non levy or short/non payment or erroneous refund of excise duty is by reason of fraud, collusion, or any wilful mis-statement or suppression of facts, or contravention of any of the provisions of the Central Excise Act or the rules made thereunder with an intent to evade payment of excise duty.

(2) A new sub-section (1A) has been inserted after sub-section (1) in section 11A. The new sub-section provides an option to the person or his agent to whom a notice has been served by the Central Excise Officer for short/non levy or short/non

payment or erroneous refund of excise duty by reason of fraud, collusion, or any wilful mis-statement or suppression of facts, or contravention of any of the provisions of the Central Excise Act or the rules made thereunder with an intent to evade payment of excise duty.

(3) Such person or his agent may pay the excise duty in full or in part as may be accepted by him, including the interest payable thereon under section 11AB and penalty equal to 25% of the excise duty specified in the notice or the excise duty so accepted by such person within 30 days of the receipt of the notice.

(4) Further, a proviso has been inserted in sub-section (2) of section 11A. Sub-section (2) provides that the Central Excise Officer shall consider the representation, if any, made by the person on whom a notice under sub-section (1) is served. He shall determine the amount of excise duty due from such person and thereupon such person shall pay the amount so determined. However, such amount shall not exceed the amount specified in the notice.

(5) The newly inserted proviso lays down that where such person has paid the excise duty in full together with interest and penalty, the proceedings in respect of such person and other persons to whom notices (referred to in point 1) have been served shall be deemed to have been concluded in respect of the matters stated therein. The proceedings shall conclude notwithstanding anything contained in sections 9, 9A and 9AA.

(6) Another proviso has been inserted in sub-section (2). This proviso lays down that in cases where such person has paid excise duty in part along with interest and penalty, the Central Excise Officer shall determine the amount of excise duty or interest which will not exceed the amount partly due from such person.

### (ii) Commissioner to direct any Central Excise Officer subordinate to him to apply to the Commissioner (Appeals) [Section 35E(2)]

Section 35E(2) of the Central Excise Act gives powers to Commissioner of Central Excise to pass certain orders. The Commissioner of Central Excise may of its own motion, call for and examine the record of any proceeding in which an adjudicating authority subordinate to him has passed any order so as to satisfy itself upon the legality or propriety of the order. Thereafter, the Commissioner may direct such authority to apply to the Commissioner (Appeals) to determine such points as may be specified by it.

The Taxation Laws Amendment Act, 2006 has amended section 35E(2) to the effect that now the Commissioner may also direct any Central Excise Officer subordinate to him (apart

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from the adjudicating authority subordinate to him which has passed the order) to apply to the Commissioner (Appeals) to determine such points as may be specified by it.

**(iii) Property may be attached provisionally to protect revenue in certain cases [New section 11DDA]**

A new section 11DDA has been inserted by the Taxation Laws Amendment Act, 2006. The provisions of this section are:

(1) During the pendency of any proceeding under section 11A or section 11D, the Central Excise Officer may provisionally attach any property belonging to the person on whom notice is served under sub-section (1) of section 11A or sub-section (2) of section 11D, as the case may be, in accordance with the rules made in this behalf under section 142 of the Customs Act, 1962.

(2) Such an attachment shall be done only when the Central Excise Officer is of the opinion that the attachment is necessary for the purpose of protecting the interests of revenue. However, a previous approval of the Commissioner of Central Excise, by order in writing, is a prerequisite for such provisional attachment.

(3) Such an attachment can be done for a period of 6 months. This period will commence from the date of the order of the Commissioner of Central Excise permitting such provisional attachment.

(4) However, this period may be extended by the Chief Commissioner of Central Excise by such further period or periods as he thinks fit. The reasons for such an extension shall be recorded in writing. It is to be noted that the total period of extension in any case shall not exceed 2 years.

(5) If an application for settlement of a case under section 32E is made to the Settlement Commission, the period commencing from the date on which such an application is made and ending with the date on which an order under section 32F(1) is made shall be excluded from the extended period mentioned in point (4).

**(iv) Information in respect of persons in certain cases to be published [New section 37E]**

This new section, added by the Taxation Laws Amendment Act, 2006 provides for publishing the name of any person and particulars of any proceedings in relation to such person, in public interest. The provisions are discussed below in detail:

(1) The Central Government may publish name of any person and any other particulars relating to any proceedings in respect of such person if it is of the opinion that it is necessary or expedient in the public interest to do so. The Government can do the publication in such manner as it thinks fit.

(2) The publication shall be made in relation to any penalty only after the time for presenting an appeal to the Commissioner (Appeals) or the Appellate Tribunal expires without an appeal being presented or the appeal, if presented, gets disposed of.

(3) In the case of a firm, company or other association of persons, the names of the partners of the firm, directors,

managing agents, secretaries and treasurers or managers of the company, or the members of the association, as the case may be, may also be published if, in the opinion of the Central Government, circumstances of the case justify it.

**II. AMENDMENT IN THE CENTRAL EXCISE RULES, 2002**

**“Wire drawing units” declared as assesseees for the period 29.05.2003 to 08.07.2004 [Retrospective amendment in rule 16]**

Supreme Court in the case of *M/s Technoweld Industries 2003 (155) ELT 209 SC* held that the process of drawing of wire from “wire rod” did not amount to ‘manufacture’. Therefore, the benefit of availment of credit of duty on inputs by the “wire drawing units” was withdrawn on 29.5.2003 by a circular issued by the Board. However, certain wire drawing units continued to pay a sum representing duty, and continued to pass on the credit of amount paid as duty to the ultimate buyer of drawn wire for further manufacture. Subsequently, the Finance (No.2) Act, 2004, with effect from 09.07.2004, inserted Note 10 in section XV of the First Schedule to the Central Excise Tariff Act, 1985 to declare the said process as amounting to ‘manufacture’. However, as the said Section Note was effective from 09.7.2004, it did not resolve the problem for the said period, i.e. 29.05.2003 to 08.07.2004.

Accordingly, show cause notices were issued to wire drawing units for recovery of CENVAT credit availed on inputs on the grounds that the process of wire drawing did not amount to manufacture for the said period. Show cause notices were also issued to the buyers of “drawn wires” who availed CENVAT credit of amount paid as duty on drawn wire, on the ground that the sum paid on clearance of “drawn wire” by wire drawing unit did not represent central excise duty. Such wire drawing units could also not claim the refund of amount paid as duty on drawn wire, on the ground of unjust enrichment.

In order to provide relief to such “wire drawing units”, which had paid a sum equal to the duty leviable on “drawn wire” after availing the credit of duty paid on inputs for the said period, the Taxation Laws Amendment Act, 2006 has retrospectively amended rule 16 of the Central Excise Rules, 2002 to declare “wire drawing units” as assesseees for the period 29.05.2003 to 08.07.2004. The amendment has regularized availment of credits at two stages [credit taken at input stage (on wire-rod) and credit taken by the downstream user of “drawn wire”] and payment of an amount representing duty at one stage (the amount paid as central excise duty on clearance of drawn wire).

In other words, wire drawing units, which had paid a sum equal to duty leviable on drawn wire, would be eligible to avail the credit of duty paid on inputs and utilize the same for payment of duty on drawn wire for the period of amendment. The sum paid by the wire drawing unit in such cases will be treated as duty and shall be allowed as credit to the buyer of drawn wire, in terms of the amendment. It is to be noted that this amendment would not create any additional liability on

any wire drawing unit which did not pay duty on drawn wire during the period of amendment.

### III. AMENDMENTS IN THE CUSTOMS ACT, 1962

Amendments have been made in sections 17, 18, 28, 104, 108, 124, 129D, 132, 133 and 137. Further, four new sections viz., 28BA, 110A, 114AA and 154B have been inserted by the Taxation Laws Amendment Act, 2006.

#### (i) Speaking order to be issued within 15 days of assessment in case of contrary claims by the assessee [Section 17]

Section 17 of the Customs Act, 1962 governs the provisions in respect of assessment. A new sub-section (5) has been inserted after sub-section (4) in section 17. The new sub-section (5) lays down that where any assessment done under sub-section (2) is contrary to the claim of the importer or exporter regarding valuation of goods, classification, exemption or concessions of duty availed consequent to any notification and in cases other than those where the importer or the exporter, as the case may be, confirms his acceptance of the said assessment in writing, the proper officer shall pass a speaking order within 15 days from the date of assessment of the bill of entry or the shipping bill, as the case may be.

#### (ii) Interest payable/receivable on the duty difference between the provisional and final assessment [Section 18]

Section 18 of the Customs Act lays down the provisions in respect of provisional assessment. Duty is paid in two stages in case of provisional assessment; firstly, at the time of provisional assessment and another at the stage of finalization of assessment. A new sub-section (3) has been inserted in section 18 to levy interest on the duty difference in the provisional and final assessment of duty. This may expedite the recovery of duty short-levied under provisional assessment of duty. Provisions of sub-section (3) are detailed under:

(1) Sub-section (3) provides that the importer or exporter shall be liable to pay interest, on any amount payable to the Central Government, consequent to the final assessment order.

(2) The interest shall be payable at the rate fixed by the Central Government under section 28AB.

(3) This interest shall be payable from the first day of the month in which the duty is provisionally assessed till the date of payment thereof.

(4) If the refund arising out of the final assessment of goods cleared for home consumption or exportation (in case the amount paid at the time of provisional assessment exceeds the amount determined to be payable at the final assessment) is not refunded within 3 months from the date of final assessment of duty, interest shall be paid to the assessee on such unrefunded amount till the date of refund of such amount.

(5) This interest shall be payable at the rate fixed by the Central Government under section 27A. The refund of duty

and interest thereon shall be subject to the conditions mentioned in point no.6 below.

(6) The amount of such refundable duty and such interest, if any shall be paid to the importer or the exporter, as the case may be, only if such amount is relatable to:

(a) the duty and interest, if any, paid on such duty paid by the importer, or the exporter, as the case may be, if he had not passed on the incidence of such duty and interest, if any, paid on such duty to any other person;

(b) the duty and interest, if any, paid on such duty on imports made by an individual for his personal use;

(c) the duty and interest, if any, paid on such duty borne by the buyer, if he had not passed on the incidence of such duty and interest, if any, paid on such duty to any other person;

(d) the export duty as specified in section 26;

(e) drawback of duty payable under sections 74 and 75.

In all other cases the amount of such refund and interest shall be credited to the Consumer Welfare Fund.

#### (iii) Adjudication proceedings to conclude in respect of a person who voluntarily deposits the full duty demanded along with interest and penalty equal to 25% of the duty [Section 28(1A)]

(1) Section 28(1) provides that where any duty is not/short levied or erroneously refunded or where any interest payable is not/part paid or erroneously refunded, the proper officer may serve notice on the person chargeable with such duty or interest in the case of any import made by any individual for his personal use or by Government or by any educational, research or charitable institution or hospital, within one year from the relevant date. In any other case the notice can be issued within 6 months from the relevant date. However, this period of 1 year and 6 months is extended to 5 years when such short/non levy or non charging or short payment of interest or erroneous refund of duty and interest is by reason of fraud, collusion, or any wilful mis-statement or suppression of facts by the importer or the exporter or the agent or employee of the importer or exporter.

(2) A new sub-section (1A) has been inserted after sub-section (1) in section 28. The new sub-section provides an option to the importer or the exporter or the agent or employee of the importer or exporter to whom a notice has been served by the proper officer for short/non levy or non charging or short payment of interest or erroneous refund of duty and interest by reason of fraud, collusion, or any wilful mis-statement or suppression of facts.

(3) Such a person may pay the duty in full or in part as may be accepted by him including the interest payable thereon under section 28AB and penalty equal to 25% of the duty specified in the notice or the duty so accepted by such person within 30 days of the receipt of the notice.

(4) Further, a proviso has been inserted in sub-section (2) of section 28. Sub-section (2) provides that the proper officer

shall consider the representation, if any, made by the person on whom a notice under sub-section (1) is served. He shall determine the amount of duty or interest due from such person and thereupon such person shall pay the amount so determined. However, such amount shall not exceed the amount specified in the notice.

(5) The newly inserted proviso lays down that where such a person has paid the duty in full together with interest and penalty, the proceedings in respect of such person and other persons to whom notices (referred to in point 1) have been served shall be deemed to have been concluded in respect of the matters stated therein. The proceedings shall conclude notwithstanding anything contained in sections 135, 135A and 140.

(6) Another proviso has been inserted in sub-section (2). This proviso lays down that in cases where such person has paid duty in part along with interest and penalty, the proper officer shall determine the amount of duty or interest which will not exceed the amount partly due from such person.

**(iv) Persons furnishing false declaration/documents under section 132, obstructing customs officers under section 133, making preparatory actions for illegal export under section 135A and customs officers guilty of offence under section 136 may be arrested too [Section 104]**

Section 104 of the Customs Act grants the power of arrest to officer of customs. Sub-section (1) of section 104 has been substituted by a new sub-section. The new sub-section lays down that if an officer of customs empowered in this behalf by general or special order of the Commissioner of Customs has reason to believe that any person in India or within the Indian customs waters has committed an offence punishable under section 132 or section 133 or section 135 or section 135A or section 136, he may arrest such person and shall, as soon as may be, inform him of the grounds for such arrest. Thus, arrest may also be made in the cases of furnishing false declaration/documents, obstructing customs officers in exercising their powers and making preparation to export any goods in contravention of the provisions of the Customs Act. Further, any officer of customs permitting or doing or abstaining from doing or concealing or conniving at any act or thing whereby any fraudulent export is effected or any duty of customs leviable on any goods is or may be evaded may also be arrested.

**(v) Summons to be issued in case of any inquiry [Section 108]**

Section 108 of the Customs Act empowers any gazetted officer to summon any person to give evidence and to produce documents in any inquiry which such officer is making in connection with the smuggling of any goods. Sub-section (1) of section 108 has been substituted by a new sub-section. The new sub-section lays down that any gazetted officer of customs *duly empowered by the Central Government in this behalf*, shall have power to summon any person whose attendance he considers necessary either to give evidence or to produce a document or any other thing in *any* inquiry which such officer

is making under this Act. Thus, with this amendment, summons cannot only be issued in connection with smuggling, but for any inquiry under the Customs Act. Further, the gazetted officer issuing the summons should be duly empowered to do so by the Central Government.

**(vi) Use of false and incorrect material to be penalized [New section 114AA]**

After section 114A of the Customs Act, section 114AA has been inserted. The new section lays down that if a person knowingly or intentionally

- ◆ makes,
- ◆ signs or uses, or
- ◆ causes to be made,
- ◆ signed or used,

any declaration, statement or document which is false or incorrect in any material particular, in the transaction of any business for the purposes of the Customs Act, shall be liable to a penalty. The penalty shall not exceed 5 times the value of goods.

**(vii) Show cause notice before confiscation of goods to be issued only with the prior approval of the officer of customs not below the rank of a Deputy Commissioner of Customs [Section 124]**

As per section 124 a written notice is to be issued to the owner of the goods before confiscating any goods or imposing any penalty on such person. Section 124 has been amended to the effect that now such a notice can be issued only with the prior approval of the officer of customs not below the rank of a Deputy Commissioner of Customs.

**(viii) Commissioner to direct any officer of customs subordinate to him to apply to the Commissioner (Appeals) [Section 129D(2)]**

Section 129D(2) of the Customs Act gives powers to Commissioner of Customs to pass certain orders. The Commissioner of Customs may of its own motion, call for and examine the record of any proceeding in which an adjudicating authority subordinate to him has passed any order so as to satisfy itself upon the legality or propriety of the order. Thereafter, the Commissioner may direct such authority to apply to the Commissioner (Appeals) to determine such points as may be specified by it.

The Taxation Laws Amendment Act, 2006 has amended section 129D(2) to the effect that now the Commissioner may also direct any officer of customs subordinate to him (apart from the adjudicating authority subordinate to him which has passed the order) to apply to the Commissioner (Appeals) to determine such points as may be specified by it.

**(ix) Term of imprisonment increased from 6 months to 2 years in case of furnishing of false declarations/documents etc. [Section 132]**

Section 132 of the Customs Act provides for an imprisonment of 6 months or fine, or both, in case of furnishing of false

declaration or documents. This term of imprisonment has been increased from 6 months to 2 years.

**(x) Term of imprisonment increased from 6 months to 2 years in case of obstruction of officers of customs [Section 133]**

Section 133 of the Customs Act provides for an imprisonment of 6 months or fine, or both, in case of obstructing officers of customs in exercising their powers. This term of imprisonment has been increased from 6 months to 2 years.

**(xi) Prior sanction of the Commissioner of Customs necessary to take cognizance in case of offence under section 135A too [Section 137]**

Section 137 lays down that previous sanction of the Commissioner of Customs is necessary for any Court to take cognizance in case of offences under section 132, section 133, section 134 or section 135. Section 137 has been amended to include offences under section 135A i.e., making preparatory actions for illegal export etc. amongst the list of offences for which the cognizance can be taken by the Courts only with the prior sanction of the Commissioner of Customs.

**(xii) Property may be attached provisionally to protect revenue in certain cases [New section 28BA]**

A new section 28BA has been inserted by the Taxation Laws Amendment Act, 2006. The provisions of this section are:

(1) During the pendency of any proceeding under section 28 or section 28B, the proper officer may provisionally attach any property belonging to the person on whom notice is served under sub-section (1) of section 28 or sub-section (2) of section 28B, as the case may be, in accordance with the rules made in this behalf under section 142 of the Customs Act, 1962.

(2) Such an attachment shall be done only when the proper officer is of the opinion that the attachment is necessary for the purpose of protecting the interests of revenue. However, a previous approval of the Commissioner of Customs, by order in writing, is a prerequisite for such provisional attachment.

(3) Such an attachment can be done for a period of 6 months. This period will commence from the date of the order of the Commissioner of Customs permitting such provisional attachment.

(4) However, this period may be extended by the Chief Commissioner of Customs by such further period or periods as he thinks fit. The reasons for such an extension shall be recorded in writing. It is to be noted that the total period of extension in any case shall not exceed 2 years.

(5) If an application for settlement of a case under section 127B is made to the Settlement Commission, the period commencing from the date on which such an application is made and ending with the date on which an order under section 127C(1) is made shall be excluded from the extended period mentioned in point (4).

**(xiii) Seized goods, documents and things pending adjudication to be released provisionally [New section 110A]**

A new section 110A has been inserted after section 110 of the Customs Act. The new section lays down that any goods, documents or things seized under section 110, may, pending the order of the adjudicating officer, be released to the owner. Such release shall be made when the owner executes a bond in the proper form with such security and conditions as the Commissioner of Customs may require.

**(xiv) Information in respect of persons in certain cases to be published [New section 154B]**

This new section, added by the Taxation Laws Amendment Act, 2006 provides for publishing the name of any person and particulars of any proceedings in relation to such person, in public interest. The provisions are discussed below in detail:

(1) The Central Government may publish name of any person and any other particulars relating to any proceedings in respect of such person if it is of the opinion that it is necessary or expedient in the public interest to do so. The Government can do the publication in such manner as it thinks fit.

(2) The publication shall be made in relation to any penalty only after the time for presenting an appeal to the Commissioner (Appeals) or the Appellate Tribunal expires without an appeal being presented or the appeal, if presented, gets disposed of.

(3) In the case of a firm, company or other association of persons, the names of the partners of the firm, directors, managing agents, secretaries and treasurers or managers of the company, or the members of the association, as the case may be, may also be published if, in the opinion of the Central Government, circumstances of the case justify it.

**IV. Amendment in the Customs Tariff Act, 1975**

**The words “all such countries” clarified to mean “developing countries each with less than 3% import share” in proviso to section 8B(1).**

As per the proviso to section 8B(1) of the Customs Tariff Act, 1975 articles originating from developing country are exempt from safeguard duty so long as the share of imports of that article from that country does not exceed 3% of the total imports of that article into India. In case of articles originating from more than one developing country, the exemption will be available if the aggregate of imports from all such countries taken together does not exceed 9% of the total imports of that article into India.

In the said proviso the words “all such countries” have been substituted with the words “developing countries each with less than 3% import share”. Thus, it has been clarified that in case of articles originating from more than one developing country the exemption from safeguard duty shall be available only if the aggregate of import from all developing countries each with less than 3% import share does not exceed 9% of the total imports of that article into India. □

## List of Institute's Publications relevant for May, 2007 Examinations

The following list of Institute's Publications is relevant for the forthcoming examination i.e. May, 2007. Students may kindly take it into consideration while preparing for the examinations.

### Final Course

#### Paper 1: Advanced Accounting

##### I. Statements and Standards

1. Framework for the Preparation and Presentation of Financial Statements
2. Accounting Standards – AS 1 to AS 29 [including revised AS 15 (2005)].

##### II. Guidance Notes on Accounting Aspects

1. Guidance Note on Treatment of Reserves Created on Revaluation of Fixed Assets.
2. Guarantees and Counter-Guarantees Given by Companies.
3. Guidance Note on Treatment of Expenditure during Construction Period.
4. Guidance Note on Accrual Basis of Accounting.
5. Guidance Note on Accounting Treatment for Excise Duty.
6. Guidance Note on Accounting for Depreciation in Companies.
7. Guidance Note on Availability of Revaluation Reserve for Issue of Bonus shares.
8. Guidance Note on Accounting Treatment for MODVAT/ CENVAT.
9. Guidance Note on Accounting for Securitisation.
10. Guidance Note on Accounting for Equity Index and Equity Stock Futures and Options (2003).
11. Guidance Note on Accounting for Corporate Dividend Tax.
12. Guidance Note on Accounting for Investments in the Financial Statements of Mutual Funds.
13. Guidance Note on Accounting for Employee Share-based Payments.
14. Guidance Note on Accounting for Fringe Benefits Tax.
15. Guidance Note on Accounting for Credit Available in respect of Minimum Alternate Tax under the Income Tax Act, 1961.

#### Paper 3: Advanced Auditing

##### I. Professional Topics/Subjects

1. Code of Ethics

##### II. Statements and Standards

1. Framework of Statements on Standard Auditing Practices and Guidance Notes on Related Services.
2. Auditing and Assurance Standards AAS 1 to AAS 34
3. Statement on Qualifications in Auditor's Report
4. Statement on the Companies (Auditor's Report) Order, 2003 [2005 Edition].

##### III. Guidance Notes/Study Guide/Monograph

*Guidance Notes on Auditing Aspects:*

1. Guidance Note on Independence of Auditors
2. Internal Control Questionnaire.
3. Guidance Note on Accountant's Report on Profit Forecasts and / or Financial Forecasts.
4. Guidance Note on Audit Reports and Certificates for Special Purposes
5. Guidance Note on Audit of Fixed Assets.

6. Guidance Note on Audit under Section 44AB of the Income Tax Act [2005 Edition].
7. Guidance Note on Audit of Abridged Financial Statements.
8. Guidance Note on Audit of Inventories.
9. Guidance Note on Audit of Debtors, Loans and Advances.
10. Guidance Note on Audit of Investments.
11. Guidance Note on Audit of Miscellaneous Expenditure.
12. Guidance Note on Audit of Cash and Bank Balances.
13. Guidance Note on Audit of Liabilities.
14. Guidance Note on Audit of Revenue.
15. Guidance Note on Audit of Expenses.
16. Guidance Note on Section 227 (3) (e) and (f) of the Companies Act, 1956.
17. Guidance Note on Certificate of Corporate Governance [2006 Edition].
18. Guidance Note on Revision of Audit Report.
19. Guidance Note on Computer Assisted Audit Techniques (CAATs).
20. Guidance Note on Audit of Payment of Dividend.
21. Guidance Note on Audit of Capital and Reserves.

#### Paper 4: Corporate Laws and Secretarial Practice

April, 2006 edition (revised as on February, 2006) is relevant for May, 2007 Examination. Amendments in the SEBI (DIP) Guidelines 2000 as amended up to February, 2006 are applicable.

#### Paper 7: Direct Taxes

1. Study Material for Direct Taxes (as amended by Finance Act, 2006) – June 2006 edition. The relevant assessment year is A.Y.2007-08.
2. Select cases in Direct and Indirect Taxes (2006) – An Essential reading for the Final Course.[Portions relating to Direct Taxes]
3. Final Course – Supplementary Study Paper – 2006 Direct Taxes and Indirect Taxes – Amendments made by the Finance Act, 2006. [Portions relating to Direct Taxes]. This publication is relevant for those who have any earlier edition (prior to June 2006 edition) of the Direct Taxes study material.

**Note** – For the purposes preparing for direct taxes, study material for A.Y.2007-08 containing the law as amended by the Finance Act, 2006 should be taken into account. This study material contains amendments made by notifications/circulars/other legislations up to 30.04.2006. The amendments made between 1.05.2006 and 31.10.2006 would be published in the Revision Test Papers for May 2007 examination. All these amendments are relevant for May 2007 examination.

#### Paper 8 : Indirect Taxes

1. Study Material for Indirect Taxes (as amended by Finance Act, 2006).
2. Select cases in Direct and Indirect Taxes (2006) – An Essential reading for the Final Course [Portions relating to Indirect Taxes]
3. Final Course – Supplementary Study Paper – 2006 Direct Taxes and Indirect Taxes – Amendments made by the Finance Act, 2006 [Portions relating to Indirect Taxes]. This publication is relevant for those who have any earlier Indirect Taxes Study Material (prior to the one as amended by Finance Act, 2006).

**Note** – For the purposes of preparing for indirect taxes, study material containing the law as amended by the Finance Act, 2006 should be taken into account. This study material contains amendments made by notifications/circulars/other legislations up to 30.04.2006. The amendments made between 1.05.2006 and 31.10.2006 would be published in the Revision Test Papers for May 2007 examination. All these amendments are relevant for May 2007 examination and hence should be taken into account.

**Professional Education Course II**

**Paper 1: Accounting**

Accounting Standards 1 to 29 [including revised AS 15(2005)].  
For the students at PE-II level, Accounting Standards and Guidance Notes related to the topics given in the study material are more relevant. They are not expected to know in detail the advanced standards like Consolidated Financial Statements (AS 21), Accounting for Investments in Associates in Consolidated Financial Statements (AS 23), Discontinuing Operations (AS 24), Financial Reporting of Interests in Joint Ventures (AS 27), Impairment of Assets (AS 28) and Provisions, Contingent Liabilities and Contingent Assets (AS 29).

For the topic of Accounts of Insurance Companies, the Insurance Regulatory and Development Authority (Preparation of Financial Statements and Auditor’s Report of Insurance Companies) Regulations, 2002 will be applicable.

**Paper 2: Auditing**

Auditing and Assurance Standards – 1 to 30.  
Students at PE II level are expected to have familiarity with all these Auditing and Assurance Standards. They are expected to know in-depth only such Auditing Standards, which have been dealt within the main text of the study material.

**Paper 3: Business & Corporate Laws**

The study material revised and updated as on 15<sup>th</sup> November 2005 edition is relevant for May, 2007 Examination. There has been no legislative change since then.

**Paper 5: Income-tax and Central Sales Tax**

Study Material for Income-tax and Central Sales Tax - June 2005 edition **read along with** “Professional Education (Course-II) – Supplementary Study Paper - 2006 – Income-tax and Central Sales-tax” containing amendments made by the **Finance Act, 2006, relevant for assessment year 2007-08.**

**Note** – For the purposes of preparing for Income-tax and central sales tax, the June 2005 edition of the study material read along with the “Supplementary Study Paper - 2006 – Income-tax and Central Sales-tax” containing the amendments made by the **Finance Act, 2006, relevant for assessment year 2007-08** should be taken into account. The study material contains the amendments made by notifications/circulars/other legislations up

to 30.04.2005 and the supplementary study paper – 2006 contains the amendments made by the Finance Act, 2006 as well as amendments made by notifications/circulars/other legislations between 1.5.05 and 30.04.2006. Further, the amendments made between 1.05.2006 and 31.10.2006 would be published in the Revision Test Papers for May 2007 examination. All these amendments are relevant for May 2007 examination.

**Modification in the eligibility test paper scheme for students of Professional Education (Course-I), (Course-II) and Final Course**

In modification of the Eligibility Test Paper Scheme Vide Announcements No.BoS/Ancmnt-7/227/05 dated July 26, 2006 and No.BOS/Announcement/227/2005 dated November 16, 2005, it has been decided to discontinue the Sunday Test Scheme with immediate effect and students covered under the Sunday Test Paper Scheme may submit test papers as per the modified eligibility test paper requirements under the postal test paper scheme. However, full credit will be given for the test papers submitted under the Sunday Test Papers Scheme. Students are advised to collect the Postal Test Papers from the respective decentralized office. This announcement is not applicable to the students who have already complied with requirements of eligibility test papers under the Sunday Test Paper Scheme or Postal Test Paper Scheme.

For the purpose of eligibility to appear in Professional Education (Course-I), Professional Education (Course-II) and Final Course to be held in the May 2007 and thereafter, it has been decided to modify the requirement of postal test papers as given below:

Course	Scheme of Eligibility Test Paper
Professional Education (Course-I)	To submit and pass in 2 postal test papers consisting of one test paper each from 2 different subjects out of 4 subjects.
Professional Education (Course-II)	To submit and pass in 3 postal test papers consisting of one test paper each from 3 different subjects out of 6 subjects.
Final Course	To submit and pass in 4 postal test papers consisting of one test paper each from 4 different subjects out of 8 subjects.

Cut off dates for submission of Postal Test papers to become eligible to appear in May 2007 Examinations:

PE (Course-I) and PE (Course-II) : January 1, 2007  
Final Course : January 31, 2007

Pass marks in each of the eligibility test paper is 45 marks.

<b>CPT Calendar upto February, 2008</b>				
Date of CPT Examination	May 6, 2007	August 5, 2007	November 4, 2007	February 3, 2008
Last date of registration with the Board of Studies	March 1, 2007	June 1, 2007	September 1, 2007	December 1, 2007
Date of release of examination form	March 2, 2007	June 5, 2007	September 5, 2007	December 5, 2007
Last date for submission of examination form	March 23, 2007	June 26, 2007	September 26, 2007	December 26, 2007
Date of publication of result	June 01, 2007	September 1, 2007	December 01, 2007	March 01, 2008

## e- learning initiatives of the ICAI

World-over e-Learning has evolved to become effective medium to impart education. It has become a buzzword among students' fraternity and no academic institution can afford not to follow this route. There are umpteen reasons why organizations introduce e- learning. In its efforts to use modern tools of information technology, the ICAI has planned to introduce e-learning portal "ICAI-Online". Initially it will be for the students of Professional Competence Course and gradually scaled up to cover other courses. In addition, 100 hours of Information Technology Training will also be imparted online. It will have following advantages for the students:



### 1. Convenience

E-learning is certainly revolutionizing the current teaching method, not only due to the easiness and low price involved but also because of the comfort in learning it may provide.

You can log on to the site from wherever you want, whenever you want, day or night i.e. 24×7×365 basis. You can even study from the comfort of your own home. You don't need to worry about the time or about arriving late for the class. In fact, you don't even need to leave your home.

### 2. Flexi Schedule

You do not have to bother how you will manage time for your oral coaching classes while you are undergoing the articulated training. E-Learning offers you flexi schedule as per your time management.

### 3. A Superior Learning Platform

Many online courses consist only of scrolling through long passages of text. The ICAI will offer a progressive, highly-interactive online learning experience involving enriching videos, ambient sound, engaging imagery and instructional narration. You will get interactive guidance while solving problems of accountancy, cost accounting, financial management and taxation.

### 4. Distinguished Faculty

You will get opportunities to interact with talented and industry-experienced instructors of the ICAI at scheduled time and resolve your queries instantaneously.

### 5. Affordability

On line courses on all six subjects of Professional Competence Course and 100 Hours Information technology training will be available at a nominal fee.

### 6. Online Discussion Boards

"ICAI-Online" shall allow you to form discussion groups or forums to facilitate discussion and collaboration with like-minded group of students having a common focus or interest.

### Online 100 Hours Information technology Training

100 Hours Information Technology Training (ITT) shall be available on this site on an optional basis. This is in addition to the existing system of classroom training through Regional Councils / Branches / other accredited institutions. Students will be able undergo ITT online and appear in the examination at the approved centres.

So, no more hassles of traveling long distances or staying away from your home for undergoing ITT.

*Expected date of implementation of online 100 Hours ITT: February 1, 2007*

## 100 hours Information Technology Training

In the new scheme of Education and Training, 250 Hours Compulsory Computer Training is replaced by 100 Hours Information Technology Training (ITT) with effect from 1<sup>st</sup> December, 2006. The new curriculum of 100 Hours ITT has been framed revamping the old curriculum. A student shall start 100 Hours of Information Technology Training only after undergoing three months of practical training by which he/she is expected to develop knowledge about the practical applications of Information Technology in various areas of professional practice. It is also desired that students should study the subject of Information Technology concurrently while undergoing 100 Hours Information Technology Training so that a proper balance between theoretical knowledge and practical application is achieved.

In order to provide the students with a reference material, the Board of Studies is providing a kit comprising of 3 modules of 250 Hours Compulsory Computer Training course material (which were used under the old scheme) and a supplementary study material. Students are advised to study only the relevant topics of these three modules along with the supplementary study material. A table giving the page references of the relevant topics of 250 hours Compulsory Computer Training Programme course material is included in the supplementary study material to facilitate the students for easy identification.

There are good number of students who registered themselves for 250 hours Compulsory Computer Training but did not start their training as on date, they should now undergo 100 Hours ITT. Such students, who have already received the course material for 250 Hours CCT, can get a copy of the Supplementary Study Material free of cost from the accredited institute where they will be undergoing 100 Hours ITT. Alternatively, the soft copy of the supplementary Study Material is available on the ICAI website [www.ica.org/Students/Courses/Computer Course](http://www.ica.org/Students/Courses/Computer Course) which can be freely downloaded.

### Common Proficiency Test – Self Assessment E-Test

Second Edition of Self Assessment E-Test has been released in form of a Compact Disc. The student who have not received it with their study materials may write to their respective regions requesting a copy of the same.

### Scholarships From The S. Vaidyanath Aiyar Memorial Fund

The Managing Committee of the S.Vaidyanath Aiyar Memorial Fund has decided to award scholarships of the value of Rs. 500 each month for a period of one year to needy and deserving articulated Assistants.

Articled Assistants who wish to avail the scholarship for the year 2006-07 should submit their applications in the prescribed form, latest by January 31, 2007.

**For further details, please write to: Shivam Kumar, Deputy Secretary, The Institute of Chartered Accountants of India, Post Box No. 7100, Indraprastha Marg, New Delhi-110002**



A view of Two-day National Level Seminar on Global Convergence of Commerce Education held at Kuvempu University, Shankaraghatta, Karnataka. Seen in picture: Prof. Madegowda, Seminar Director, Shri Manjunath, Faculty Member, Dr. T.P.Ghosh, Director of Studies, ICAI, Shri D.H. Shankara Murthy, Hon'ble Higher Education Minister, Govt. of Karnataka, Prof. B.S.Sherigar, Hon'ble Vice-Chancellor, Kuvempu University, Shri B.S.Yediyurappa, Hon'ble Deputy Chief Minister, Government of Karnataka and Prof. Kantakudige, Registrar, Evaluation.

### Eligibility norm for Professional Education (Course –II) students who have switched over/will switch over to Professional Competence Course (PCC) to appear in Professional Competence Examination (PCE)

**Pre-conditions for eligibility to appear in Professional Competence Examination (PCE) as shown in the Table below:**

- ◆ All such students have already appeared in Professional Education (Examination –II) and passed one of the Groups or could not pass any of the Groups or they were eligible to appear in the Professional Education (Examination-II) as on 13.9.2006.
- ◆ It is clarified that 'eligible to appear in Professional Education (Examination-II) is not assessed with reference to the eligibility certificates issued on or before 13<sup>th</sup> September, 2006. Students who have submitted all test papers and whose test papers were pending for evaluation on the cut off date, i.e. 13<sup>th</sup> September, 2006 are also covered under this scheme.
- ◆ Students should successfully complete 250 Hours Compulsory Computer Training programme / 100 Hours Information technology Training programme before appearing in the PCE.

Sl No.	1	2	3
	Category of students of PE-II	Eligibility to appear in Professional Competence Examination ( PCE)	<b>Eligibility to appear in Professional Competence Examination \ (PCE)</b>
		As announced in the preparatory announcements and given in the Prospectus and other publicity materials	<b>As Modified</b>
1.	PE- II students who have passed foundation examination	May 2008	<b>May 2007</b>
2.	PE- II students who have passed PE-I examination held in May 2005 or in any earlier term	May 2008	<b>May 2007</b>
3.	PE- II students who have passed PE-I examination held in November 2005	May 2008	<b>November 2007</b>

Other students of Professional Education (Course-II) who have passed Professional Education (Examination-I) held in May 2006 or thereafter should complete 15 months of articleship training 3 months before the first day of the month in which Professional Competence Examination will take place. They should also complete 250 Hours of Compulsory Computer Training Programme / 100 Hours of Information Technology Training before appearing in the Professional Competence Examination. □

**Check your Address :** All students should check their mailing address printed here. In case, there is any change or the PIN Code (Postal Index Code) is either missing or incorrect, kindly inform immediately the concerned Regional Office giving full particulars of your address along with correct PIN Code. This would enable us to ensure smooth and prompt delivery of the Newsletter.

**Editor : CA. T.N. Manoharan**

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