

# 18th All India C.A. Students' Conference

November, 2005 Vol 9 No 6

## Message from the Chairman, Board of Studies

Dear Students,

At the onset I wish to convey my best wishes for festival season. November is also month of examinations. Completion of examinations will bring much awaited respite. However, take care that the moments of fun and recreation does not take away too much of your precious time. It is crucial for you to use your time constructively. To clear future examinations you must put in continuous and concerted efforts. In my message for this issue I wish to give you a few tips as to how to successfully pass CA examinations. These are based on the experiences of several students like you. The points are not exhaustive, and you need to evolve a study plan that is best suited to you. However, any plan must adequately cover these points.



First of all start early. It is a normal tendency of several students to put off their study efforts endlessly. This leads to accumulation of the studies required to render them unmanageable. The sooner you start, the better will be your preparation. Do not waste even a single day.

Secondly, you must write. It is often found that many students are not able to express correctly the answers they happen to actually know. This can be improved if you practise on paper. Some students are comfortable with numerical problems and restrict themselves to attempting the same. This is not a healthy practice. You need to write down theoretical concepts. Prepare notes and summaries that will make revision simpler. Attempt the question papers of earlier examinations. You will be delighted to learn that Board of Studies is bringing out compilations of questions set in previous examinations. Likewise, compilation of questions and answers are separately brought out. You may go through the announcement printed on page 28.

Next, you should take assistance. If you think that you need a little help, do not hesitate. The help is available very close to you. You may discuss difficult topics with your college or university teacher. You can always write to Board of Studies and take the guidance from subject experts available with the Institute.

Justify all the subjects. It is also noticed that some students try to complete studying for one subject and then move on to another subject. In the process many of them tend to forget the initial subject studied. It is suggested that you should prepare plans in such a manner that sufficient time is given to all subjects on a continuous basis-theoretical as well as numerical.

Take a break. It is often said that *all work and no play makes jack a dull boy*. Course of chartered accountancy is no exception. Students need to take time offs, to maintain the interest in the studies. Studying continuously for a long number of hours will render it boring and reduce the level of assimilation. Take a 15-20 minutes break after every hour or two depending upon your capabilities.

**Dates:** December 8 & 9, 2005

**Venue:** Ravindra Natya Grah, R.N.T. Marg, Indore

**Students are invited to propose papers for the conference. Details inside...**

w	Highlights of Mid-Term Monetary Policy-2005-06 .....	3
w	Managing Strategically .....	6
w	Commissioner's power to revise other orders (Sec. 264) .....	8
w	Safety Stock? .....	10
w	Working Capital Management .....	12
w	Options—Basic Concepts and the Values .....	14
w	Cost and Management Accounting : A Historical Perspective .....	17
w	Announcement- Applicability of Accounting Standards .....	20
w	Western India CA Students' Regional Conference- Nagpur .....	20
w	Accounting Standards Interpretation (ASI) 29 .....	21
w	250 Hours CCT Programme .....	22
w	Announcements .....	23
w	Students' Corner .....	25

## ARTICLE

Lastly, be wary of myths prevailing around you. Do not harbour feelings that the course is unmanageable. Or the Institute restricts the pass percentages. Such baseless myths will only reduce your confidence and discourage you. You must believe in yourselves. To quote Swami Chirmayananda – *Incompetency in life generally springs from our false and hasty conclusions that we are impotent, insignificant and ineffective.*

With best wishes,

Yours truly,

Jaydeep Narendra Shah

## 18th All India C.A. Students' Conference

**Dates:** December 8 & 9, 2005

**Venue:** Ravindra Natya Grah, R.N.T. Marg, Indore

### Technical Session I

#### Accounting and Auditing

- ❖ Impairment of Assets ❖ CARO, 2004

### Technical Session II

#### Taxation

- ❖ Fringe Benefit Tax ❖ Procedural Aspects of CENVAT Credit

### Technical Session III

#### Corporate Laws

- ❖ Significant Changes in the Companies Act
- ❖ Clause 49 of the Listing Agreement - Corporate Governance & Independent Directors

### Technical Session IV

#### General

- ❖ Career Opportunities of Chartered Accountancy Profession in IT Industries
- ❖ Education and Training of Chartered Accountancy

### Special Session

- ❖ Winning Strategies for passing CA Examination

We have received a number of paper from the students. These are presently under review. A list of accepted papers will be announced through the website of the Institute. Paper writers will be invited to present papers in the respective technical sessions. They will be entitled to get reimbursement of to and fro railway fare by shortest route in AC 3 Tier/ First Class.

**Registration fee:** Rs. 500      *Rs. 400 (if registration is made on or before 30th September)*  
*Rs. 450 (if registration is made after 30th September on or before 31st October)*

All correspondence relating to registration may be addressed to:

**Ms Kemisha Soni / Mr Amit Ramani,**

Indore Branch of CIRC of the ICAI, 101 Urvashi, First Floor, Jaora Compound, Indore 452001.

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E-mail: [cicasaindore\\_casc@rediffmail.com](mailto:cicasaindore_casc@rediffmail.com)

### *Students are invited to join the Conference*

#### Advertisement 'Order Form' for the Conference

Please reserve us a space in the following advertisement medium on the occasion of 18<sup>th</sup> All India CA Students' Conference in Indore.

#### The Souvenir-cum-Handbook

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|--|------------|---|------------|
| <input type="checkbox"/> Colour Back Page          | Rs. 75,000 | <input type="checkbox"/> Colour Page (Inside Cover) | Rs. 60,000 |
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| <input type="checkbox"/> Full Page (B&W)           | Rs. 18,000 | <input type="checkbox"/> Half Page (Coloured)       | Rs. 16,000 |
| <input type="checkbox"/> Half Page (B&W)           | Rs. 7,500  | <input type="checkbox"/> Quarter page (B&W)         | Rs. 4,500  |
| <input type="checkbox"/> Bottom Strips in Handbook | Rs. 3,000  |   |            |

#### Other Mediums

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| <input type="checkbox"/> Stall at Conference Venue            | Rs. 30,000 | <input type="checkbox"/> Banners outside hall (per banner)                       | Rs. 9,000 |
| <input type="checkbox"/> Sponsorship of Entertainment program |            | <input type="checkbox"/> Sponsorship of kit (Entire kit or individual component) |           |

**(Please tick the appropriate check box)**

Page Size - 15 x 22 cm

Instructions, if any \_\_\_\_\_

We are enclosing herewith a Cheque/DD No. \_\_\_\_\_ Dated \_\_\_\_\_ for Rs. \_\_\_\_\_ drawn in favour of **The Indore Branch of CIRC of ICAI**, payable at Indore along with the layout of our advertisement material in soft copy and one printout.

Signature \_\_\_\_\_

## Highlights of Mid-Term Monetary Policy-2005-06

Prem J Bhutani

The Reserve Bank of India (RBI) recently announced its Mid-Term Review of the Monetary Policy 2005-06. In the following paragraphs, we will highlight its main points.

- ◆ The Indian economy recorded an impressive performance during the first quarter of 2005-06. The real GDP growth in the first quarter of 2005-06 accelerated to 8.1% from 7.6% in the corresponding period of the preceding year. Encouraged with improved performance, the RBI has pegged the GDP growth targets at 7-7.5% for the year 2005-06 raised from 7% kept earlier.
- ◆ The index of industrial production (IIP) increased by 8.8% during April-August 2005 as compared with the increase of 8% in the corresponding period of the previous year. There are signs of sustained growth in the production of basic goods, capital goods and consumer goods.
- ◆ Excess to normal rainfall was observed in the country as a whole. It augers well for the Kharif output.
- ◆ Lead information on the major indicators of services sector indicates continued buoyancy in the second quarter of 2005-06.
- ◆ Inflation, on an average basis, based on the WPI was 5.3% as on October, 2005 as compared with 6.2% a year ago. At a disaggregated level, the prices of primary articles increased by 2.5% as compared with an increase of 3.8% in the previous year. Prices of manufactured products increased by 2.6% as compared with 7.2% a year ago. The annual increase in prices of the 'fuel, power, light and lubricants' group at 12 percent was higher than 10.7 percent a year ago. Excluding the fuel group, however, inflation on an annual basis at 2.1% was significantly

lower than headline inflation. During 2005-06 so far, oil prices in the international markets have continued to remain high and volatile. The full effects of the pass-through of the increase in international oil prices have so far been dulled and the underlying inflation pressures have been contained. In the remaining part of the year, inflation conditions will warrant continuous vigil.

- ◆ Inflation as measured by variations in the consumer price index (CPI) for industrial workers on an annual average basis was 4.1% in August 2005 as against 3.4% a year ago.
- ◆ India's exports during April-September 2005 increased by 20.5% in U.S. dollar terms as compared with 30.8% in the corresponding period of the previous year. India's merchandise export growth surpassed that of most Asian countries during this period. Imports rose by 33.1% as against an increase of 37.3% in the corresponding period last year. During 2004-05, the current account recorded

### Bank Rate

Bank Rate is the official minimum rate at which the Central Bank (RBI) is prepared to rediscount the approved bills of exchange held by banks or to lend on approved securities to banks.

### Cash Reserve Ratio

Cash Reserve Ratio refers to that portion of total deposits of a commercial bank which it has to keep with the RBI in the form of cash reserves.

### Repo

Repo is a transaction in which two parties agree to sell and repurchase the same security. Under such an agreement the seller sells specified securities with an agreement to repurchase the same at a mutually decided future date and a price. Similarly, the buyer purchases the securities with an agreement to resell the same to the seller on an agreed date in future at a predetermined price. Such a transaction is called a Repo when viewed from the prospective of the seller of securities (the party acquiring fund) and Reverse Repo when described from the point of view of the supplier of funds. Effectively the seller of the security borrows money for a period of time (Repo period) at a particular rate of interest mutually agreed with the buyer of the security who has lent the funds to the seller. The rate of interest agreed upon is called the Repo rate. The Repo rate is negotiated by the counterparties independently of the coupon rate or rates of the underlying securities and is influenced by overall money market conditions. The Repo/Reverse Repo transaction can only be done between parties approved by RBI and in securities as approved by RBI (Treasury Bills, Central/State Govt securities)

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a deficit of U.S. \$ 6.4 billion after remaining in surplus over the preceding three years beginning 2001–02. A key factor underlying the phenomenon of current account surplus has been the buoyancy in net invisible earnings. Net capital inflows also remained buoyant in April–June 2005.

- ◆ Global economy remained slackened in the second quarter of 2005, stalled by weak growth in the Euro area and Japan though domestic demand was sustained in the US. In emerging Asia – led by China and India – as well as in several developing countries in Latin America, the Middle East and Russia, growth has been robust. Oil prices remain the single largest risk to the global economy, exacerbated by the continued increase in global demand, geopolitical uncertainties and a series of supply disruptions.
- ◆ The Policy recognizes several factors which pose risks to the outlook of growth. These include, infrastructural bottlenecks, high inflation rate of assets especially housing prices, continuous and volatile increase in crude oil prices in the international market, widening trade deficit and erratic behaviour of international interest rates. All these factors warrant close monitoring for sustaining the growth process with a tolerable level of inflation.
- ◆ There has been no change in the Bank Rate. It has been left unchanged at 6%.
- ◆ The Cash Reserve Ratio has also been kept unchanged at its present level of 5%.
- ◆ In view of the current macro-economic and over all monetary conditions, the fixed reverse repo rate under the liquidity adjustment facility (LAF) of the RBI has been increased by 25 basis points w.e.f. October 26, 2005 to 5.25 % from 5%.
- ◆ The fixed repo rate under the LAF will be 6.25% effective October 26, 2005 increased from 6%. The increase in the repo and reverse repo rates could translate into an increase in deposit and lending rates.
- ◆ The interest rates continue to be regulated and the Indian Banks' Association (IBA) has been asked to constitute technical groups for considering deregulation of interest rate on savings and lending rates on small loans upto Rs 2 lakh.
- ◆ The Benchmark Prime Lending Rate (BPLR) system, which has been followed by banks since November 2003, is being reviewed. It is being felt by the RBI that the current BPLRs do not truly reflect the true cost structures. Most of the banks are charging interest much below their BPLRs especially on auto loans and credit cards. On the other hand, portfolios, such as personal loans are sitting on fat margins. There is a need to standardize this discrepancy in pricing, feels RBI. That is why it is reviewing the existing system and trying to make it more transparent and clear.
- ◆ The Banks are being allowed to increase their consolidated exposure to the capital market to 40% of their net worth from 20% with the earlier ceiling of 5% of total outstanding advances as on March 31 of the previous year being scrapped. This would align the banks' risk taking capacity with their net worth. Banks having sound internal control and robust risk management systems can approach the RBI for higher limits.
- ◆ Banks have been advised to step up credit to small and medium enterprises. They have also been asked to formulate liberal and comprehensive policies for extending loans to the small and medium enterprises sector.
- ◆ Public sector banks have again be asked to look into the needs of priority sectors especially agriculture. They have been asked to formulate special agricultural credit plans in order to achieve distinct improvement in the flow of credit to agriculture.
- ◆ An internal group was set by the RBI for strengthening Regional Rural Banks (RRBs) and making them viable. The Group recommended merger/amalgamation of RRBs to improve operational viability, change of sponsor banks to enhance competitiveness, regulatory and supervisory strengthening and scope for improving profitability. The mid-term policy reiterated these recommendations.
- ◆ The general provisioning requirement for 'standard advances' has been raised from 0.25% to 0.4%. This means banks will need to make an additional provision of Rs. 800 crore. This decision has been taken to ensure good growth in consumer lending.
- ◆ In order to improve liquidity in security market, the RBI has permitted intra day short sales. Short sales are sales of securities that the seller does not own but needs to

borrow to deliver to the buyer. Currently, this Negotiated Dealing System (NDS) is exclusively for banks and primary dealers. Financial Institutions are not participating in the system at present. The mechanism would allow the banks or the SGL account holders to sell the securities on behalf of the clients and later take delivery of the securities during the day from their respective customers.

- ◆ The Reserve Bank of India has decided to extend electronic trading in gilts to insurance companies. This move is likely to make their transactions easy. This system provides for less price manipulation, minimum impact cost and quotes being available on a real time basis.
- ◆ The RBI said that special purpose vehicles (SPVs) or any other entity notified by the central bank, that are set up to finance infrastructure companies and projects would be treated as financial institutions and External Commercial Borrowings (ECBs) raised by such entities would be considered under the approval route.
- ◆ With a view to facilitate capacity expansion and technological upgradation in the Indian textiles units

after phasing out of the Multi-Fiber Agreement, it is proposed to allow banks to issue guarantees or standby letters of credit in respect of ECBs raised by textile companies for modernization or expansion of textile unit. Such applications would be considered under the approval route subject to prudential norms.

- ◆ The RBI has issued guidelines to banks with regard to relief measures to be provided in areas affected by natural calamities from time to time.
- ◆ The RBI would initiate a supervisory review process with selected banks having significant exposure to some sectors, namely real estate, highly leveraged NBFCs, venture capital funds and capital markets, in order to ensure that effective risk mitigants and sound internal controls are in place for managing such exposures.
- ◆ The RBI has asked banks to check the credit quality in the back drop of the high expansion in non-food credit so that a positive climate prevails with minimum risks and constraints. The rising share of housing and real estate, in particular, has warranted precautionary policy action to ensure credit quality.

□

## Managing Strategically

Saroj Datta

**“Without a strategy the organisation is like a ship without a rudder”**

– Joel Ross and Michael Kami

In a hyper competitive marketplace, companies can operate successfully by creating and delivering superior value to target customers and also learning how to adopt to a continuously changing business environment. So to meet changing conditions in their industries, companies need to be farsighted and visionary, and must develop long-term strategies. Strategic planning involves developing a strategy to meet competition and ensure long-term survival and growth. The overall objective of strategic planning is two fold:

- ◆ To create competitive advantage, so that the company can outperform the competitors in order to have dominance over the market
- ◆ To guide the company successfully through all changes in the environment

The present organizational operations are highly influenced by the increasing rate of change in the environment and the increasing turbulence of that change. Changes can be external to the firm or it may be change introduced to the firms by the managers. It may be manifest in the blurring of industry and firm boundaries, driven by technology, deregulation, or, indeed, globalization itself. As consequence, a vital task for management of the firm is to create and respond to change. Change management will become increasingly important,

and all managers will need to become accomplished in the management of change.

Managing for today typically involves fine-tuning current operations, introducing incremental changes with strategy staying reasonably fixed. Managing for tomorrow requires different skills. To have the foresight and knowledge to imagine how the firm will look in the future requires creating a vision of what the firm and its environment is likely to look like. To move toward realizing such a vision demands not only good leadership skills but also an understanding of what capabilities will be required and specific planning to acquire or develop them.

Thus strategic planning consists of developing a company mission (to give it direction), objectives and goals (to give it means and methods for accomplishing its mission), business portfolio (to allow management to utilise all facets of the organisation), and functional plans (plans to carry out daily operations from the different functional disciplines).

No matter how well the strategic planning process has been designed and implemented, success depends on how well each department performs its customer-value-adding activities and how well the departments work together to serve the customer. Value chains and value delivery networks have become popular with organisations that are sensitive to the wants and needs of consumers.

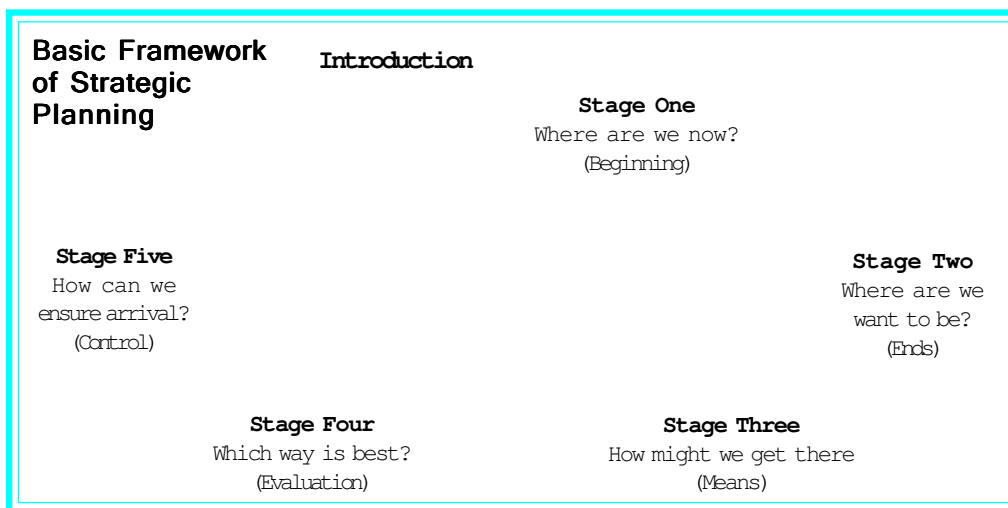
Ultimately the aim of strategic planning is to save the company's business products, services and communications so that they achieve targeted profits and growth.

### Management Philosophy

It is more important to do what is strategically right than what is immediately profitable.

### Framework

The basic framework of strategic planning process can be described in a sequence of five stages as shown in the picture.



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**Stage One:** This is the starting point of strategic planning and consists of doing a situational analysis of the firm in the environmental context. Here the firm must find out its relative market position, corporate image, its strength and weakness and also environmental threats and opportunities. This is also known as SWOT (Strength, Weakness, Opportunity, Threat) analysis.

**Stage Two:** This is a process of goal setting for the organisation after it has finalised its vision and mission. A strategic vision is a road map of the company's future – providing specifics about technology and customer focus, the geographic and product markets to be pursued, the capabilities it plans to develop, and the kind of company that management is trying to create.

An organisation's Mission states what customers it serves, what need it satisfies, and what type of product it offers.

**Stage Three:** Here the organization deals with the various strategic alternatives it has.

**Stage Four:** Out of all the alternatives generated in the earlier stage the organization selects the best suitable alternative in line with its SWOT analysis.

**Stage Five:** This is a implementation and control stage of a suitable strategy. Here again the organization continuously does situational analysis and repeats the stages again.

### An Example

The Company – Continental Airlines, a major U.S. airline in 1994

#### Stage One: Situational Analysis

- ◆ Performance – worst, among all major U.S. airlines.
- ◆ Profitability – least, among all major U. S. airlines.

#### Major Drawback

- ◆ Lack of reliability.

In 1994, Continental planes arrived on time only 61 percent of the time, placing it dead last in the influential Air Customer Satisfaction Study produced by J. D. Power & Associates.

#### Customer's Opinion

Airline travelers ranked on-time performance as the most important factor in deciding which airline to fly on. Reliability was the primary metric passengers used to determine an airline's quality. Continental Airlines was rated worst by the customer's on the basis of this parameter.

#### Reason

- ◆ Service hampered severely due to improper cost cutting.
- ◆ Unpredictable and unreliable.

#### Results

- ◆ A lot of empty planes.
- ◆ Lousy product.
- ◆ Nobody particularly wanted to buy the product.

#### Stage Two: Goal Setting

- ◆ To rank among the first three major U.S. airlines.

#### Stage Three: Strategic Alternatives

- ◆ Airlines on-time performance: to be improved.
- ◆ Reliability: to be increased.
- ◆ Employee satisfaction level: to be increased.

#### Stage Four and Five: Implementation and Control

- ◆ Every employee would receive a bonus of \$65. The total cost to the airline would be \$2.6 million. The idea was to improve the performance by spending more money and it worked.
- ◆ Employees were to be better managed to increase reliability. Hence, a new set of guidelines were framed to replace employee manual. Under these guidelines, frontline employees were given significant decision-making power to fix customer problems. For example, if a flight is canceled, a customer service agent might have to decide which passengers should receive priority to get on the next flight. Under the old system, the employee would have had to refer to the rule book, and if that did not provide an answer, ask a higher-level manager. This inflexible approach led to significant frustration among both passengers and employees.
- ◆ Decision-making power to be concentrated in the hands of employees. This meant giving them the ability to solve customer problems in creative ways, which has had a dramatic impact on customers' perception of the quality of service they get at Continental Airlines.

#### The Final Result

- ◆ In 1995, Continental Airlines was rated fifth for its on-time performance.
- ◆ In 1996, the airline finished second.
- ◆ Since then the airline has not dropped out of the top three. □

## Commissioner's power to revise other orders (Sec. 264)

Arindam Lahiri



Sec. 264(1) provides that the Commissioner may, either on his own motion or on an application made by the assessee for revision,

- ◆ call for the record of any proceeding under this Act,
- ◆ in which such order has been passed by an authority subordinate to him; and
- ◆ may make such inquiry or cause such inquiry to be made, and
- ◆ subject to the provisions of this Act,
- ◆ may pass such orders thereon,
- ◆ not being an order prejudicial to the assessee, as he thinks fit.

However, Explanation 1 to Sec. 264 provides that an order by the CIT declining to interfere shall not be deemed to be an order prejudicial to the assessee.

### Sec. 263 vis-à-vis Sec. 264

The revisionary powers u/s 263 and 264 are mutually exclusive. While Sec. 263 applies to revision of an order prejudicial to the interest of revenue, Sec. 264 pertains to revision of other orders. An order passed u/s 263 is intended to protect the interests of the revenue while an order u/s 264 cannot be prejudicial to the assessee.

### Time Limits

The CIT, acting on his own motion, cannot revise an order after a period of one year from the date when the order was passed. Where the assessee makes such application before the CIT, the application should be made within one year from the date when the order in question was communicated to him.

However, the Commissioner may, if he is satisfied that the assessee was prevented by sufficient cause from making the application within that period, admit an application made after the expiry of limitation period of one year, or on the date on which he otherwise came to know of it, whichever is earlier.

In *Priyanka Metals (P.) Ltd. Vs. Asst. CIT (2003) 133 TAXMAN 423* the demand notice was sent to the assessee even though the assessment order was not sent. Thus, the assessee had the knowledge that the assessment order was passed. The assessee applied for obtaining the copy of assessment orders belatedly and after filling the application, obtained the certified copy only after three years.

*The author is a Kolkata based practising chartered accountant.*

Thus, the petitioner failed to pursue the case seriously. As per the provisions of Sec. 264(3), no case was set out to the effect that the petitioner after knowledge as per the demand notice was prevented by any cause from filing revision within one year. It was a case of callous negligence of the petitioner and the petitioner himself was responsible for belated filing of the revision after five years of having intimation of the passing of the assessment orders. Thus, the order dismissing revision on the ground of limitation was in accordance with law.

The Commissioner shall not revise any order under this section in the following cases:

- (a) Where an appeal against the order lies to the Commissioner (Appeals) or to the Appellate Tribunal but has not been made and the time within which such appeal may be made has not expired; or
- (b) in the case of appeal to the CIT (Appeals) or the Appellate Tribunal the assessee has not waived his right of appeal; or
- (c) Where the order is pending on an appeal before the Commissioner (Appeals); or
- (d) Where the order has been made the subject of an appeal to the Commissioner (Appeals) or to the Appellate Tribunal.

### Circular No. 367 dated 26.7.1983

An order cannot be said to have been made subject of an appeal if the appeal has been disposed of by the CIT (Appeals) or the Appellate Tribunal without passing an order u/s 251(1) or 254(1) on merits.

The Calcutta High Court has held in *Nicco Corporation Ltd. Vs. CIT (2003) 129 TAXMAN 875* that under the provision of Sec. 14 of the Limitation Act, in a civil proceeding the time taken for unsuccessful proceeding with a particular civil litigation is always excluded and ignored so much so that the litigant can approach before the appropriate forum for appropriate remedy.

Hence, where assessee's application has been rejected by CIT (Appeals) or ITAT without passing an order thereon on merits and during this process, the time limit of one year expires, this will be a sufficient cause by which the assessee was prevented from taking out the application for revision as it proceeded bona fide with such appeal previously.

A fee of Rs. 500 is payable while making an application u/s 264. Where an application has been made by the assessee for revision, the CIT must pass an order thereon within one year from the end of the financial year in which the application has been made. However, in computing the limitation period of one year, the time taken by the CIT for re-hearing under the proviso to Sec. 129 and any period during which any proceeding under this section is stayed by an order or injunction of any court shall be excluded.

For example, suppose the assessee makes the application for revision on 15<sup>th</sup> April, 2005. The CIT should pass the order u/s 264 within 31<sup>st</sup> March, 2007. However, if there was a stay of 3 months from 1<sup>st</sup> May, 2005 to 31<sup>st</sup> July, 2005, this period shall be additionally allowed for passing the order. Hence, the time limit for passing the order will expire on 1<sup>st</sup> July, 2007.

However, where the CIT is directed by the ITAT, High Court or Supreme Court to pass an order under this section, there shall be no time limit for passing such order.

#### **Ex parte order should be passed only where assessee acts mala fide**

In *Smt. Rani Agrawal Vs. Asst. CIT (2004) 135 TAXMAN 418* the Allahabad High Court held that a dispute as far as possible should be decided on merits after affording reasonable opportunity of hearing to the parties. In such matters, the Court should adopt a liberal and justice-oriented approach. In this case, the Commissioner decided revisions filed by the assessee u/s 264 ex parte saying that on the appointed date none on behalf of assessee appeared before him. Assessee alleged that her counsel filed adjournment application on such date. The High Court, under a writ petition filed before it, held that there was no allegation of mala fides against assessee seeking adjournment or in any way delaying hearing of revisions. The High Court quashed the impugned order passed by the CIT and the commissioner was asked to hear and decide the revision afresh and after providing an opportunity of hearing to the assessee.

#### **Partial Merger Vs. Complete Merger**

The Supreme Court has held in *Hindustan Aeronautics Ltd. Vs. CIT (SC - 2000) 110 TAXMAN 311* that the Commissioner has no power to revise any order u/s 264 if the order has been made subject to an appeal before the Tribunal, even if the relief claimed in the revision is different from the relief claimed in the appeal and irrespective of the fact whether the appeal is by the assessee or by the department.

This is because Sec. 264(4) provides that the Commissioner shall not revise any order under this section in a case where the order has been made the subject of an appeal to the Tribunal.

Sec. 263(1), where a revision is permissible in case of orders which are prejudicial to the interest of revenue, provides in Explanation (c) thereof that where any order referred to in this sub-section and passed by the Assessing Officer had been the subject-matter of any appeal, the powers of the Commissioner under this sub-section shall extend to matters as had not been considered and decided in such appeal.

Hence, the legislative intent in case of Sec. 263 is partial merger and the issues not raised in appeal can be considered by the CIT u/s 263. However, Sec. 264 incorporates the concept of complete merger and if the assessment or penalty order has been made the subject-matter of appeal before the CIT (Appeals), the assessee cannot make an application u/s 264 even though the relief claimed in revision is different from that claimed in appeal.

The Madras High Court has held in *Kadri Mills (Coimbatore) Ltd. Vs. CIT (2003) 131 TAXMAN 215* that the remedy u/s 264 is not meant to serve as a supplement to remedy available by way of an appeal to the assessee. Hence, an assessee has either to choose appellate forum or revisional forum and should not avail of both forums with regard to the same order. Where the assessee has chosen to file an appeal, it is for assessee to seek all its remedies in respect of matters which can be considered by appellate forum, before such forum and his omission to do so cannot afford a jurisdiction for invoking revisional jurisdiction.

#### **Relief u/s 264 is mandatory**

If the assessee has been over-assessed under the provisions of the Act, regardless of whether the over-assessment is a result of assessee's own mistake or otherwise, the Commissioner has the power to correct such an assessment u/s 264(1). If the Commissioner refuses to give relief to the assessee, in such circumstances, he would be acting de hors the powers under the Act and the provisions of the Act.

#### **Order u/s 179 is revisable u/s 264**

Sec. 179 deals with personal liability of directors of private company in liquidation. The Allahabad High Court has held in *Afzal Ahmed Vs. UOI (2004) 136 TAXMAN 201* that even if an order u/s 179 is not appealable, it is certainly revisable u/s 264.

#### **Remedy against order u/s 264**

An order passes by the Commissioner u/s 264 is not appealable. However, a writ petition can be filed. The Allahabad High Court has held in *State of Uttar Pradesh Vs. UOI (2004) 139 TAXMAN 413* that where a revision petition against an order is maintainable u/s 264, writ petition cannot be entertained.

□

## Safety Stock?

Bala S Vaithya

### Why Safety stock?

In Practice, demand or usage of stocks is not known with certainty. In addition, there is usually a degree of uncertainty associated with the placement of an order and delivery of stocks.

To protect itself from conditions of uncertainty, a firm will maintain a level of **SAFETY STOCKS** for Raw mat. WIP, FG stk. Thus SAFETY Stocks are the amount of stocks that are carried in excess of expected use during lead time to provide a cushion against running out of stocks.

**Take this Example:** A firm that sets its re-order point on the assumption that avg.lead time will be 2 weeks with an avg.weekly usage of 120 units.

Now the company will re-order [without safety stk] when the stock comes to 240 units. [120 5 2]

**Stock out situation:** There are 2 possible ways for stock out situation: They are:

(i) **DEMAND is uncertain:**— from the above example, if the avg.weekly usage increases to 140 units per week. Then, there will be a stock out situation; the company should re-order when stock reaches 280 units [140 5 2]. i.e the company should have safety stocks of 40 units than before.

Simply we can say that RE-ORDER Pt.

$$= \{ \text{avg.usage} \times \text{avg.lead time} \} + \text{Safety stock}$$

In the above example:  $= \{120 \times 5 \times 2\} + 40 = 280$  units

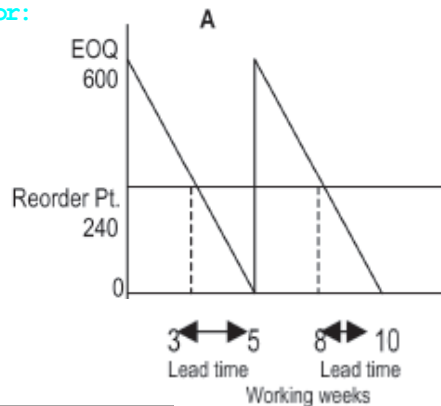
(ii) **LEAD TIME is uncertain:**— from the above example, if the avg.lead time increases to 3 weeks. Then there will be a stock out situation; the company should re-order when stock reaches 360 units [120 5 3] i.e the company should have safety stocks of 120 units.

Simply, we can say that RE-ORDER Pt.

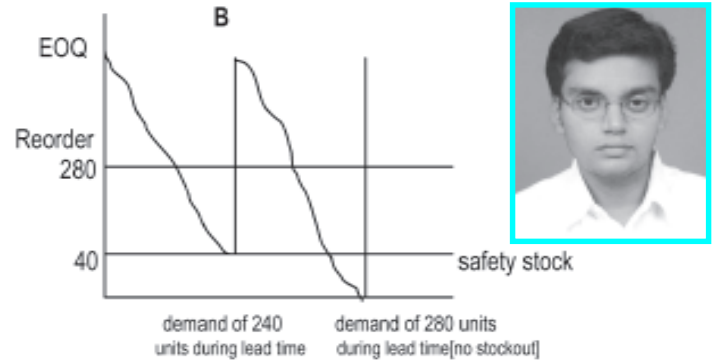
$$= \{ \text{avg.usage} \times \text{avg.lead time} \} + \text{Safety stock}$$

In the above example:  $= \{120 \times 5 \times 2\} + 120 = 360$  units

### Graphical behavior:



The author is a student of Final Course.



**A = demand known with certainty**

**B = demand not known with certainty and role of safety stocks.**

[Note: Both demand & lead time may increase simultaneously then you should work accordingly]

### Explanation of graph

**Take this example:** The firm has ordered 600 units where the consumption of these units is 5 weeks.

A firm that sets its re-order point on the assumption that avg.lead time will be 2 weeks with an avg.weekly usage of 120 units.

**In graph A:** the demand is known with certainty i.e 120 units is consumed per week. So, now the company will re-order [without safety stock] when the stock comes to 240 units. [120 x 2]. So there is no need of safety stock.

**In graph B:** the demand is uncertain i.e weekly usage is not consumed evenly in all 5 weeks. If there is excess usage than average weekly usage, then it leads to stockout situation. Say if weekly usage goes to 140 units per week for 2 weeks then there will be a stockout situation of 40 units i.e say eg 140 in week 1 & 2, 120 in week 3. Then our usage is [140 + 140 + 120 = 400]. But in 4<sup>th</sup> & 5<sup>th</sup> week we need [120 + 120 = 240] but we have only 200 units. so there arises stockout of 40 units. Hence, we should keep 40 units as safety stock.

### Impact of Keeping Safety Stock:

Maintaining high safety stock may some time lead to high holding cost.. so in such a case the company should compare cost of holding high safety stock and cost of stock out. Company shall adopt the least. **The level should be set to where the cost of a stockout plus cost of holding the safety stocks are minimized.**

Once the stock out costs have been estimated, the cost of holding safety stocks should be compared for various demand levels. However it is **preferable to use probabilities** to different potential demand levels and to decide on the appropriate

quantity of safety stocks.

**The Use of Probability Theory For Determining Safety Stocks**

**Why probability?**

By using probability theory, it is possible to calculate the expected values for various safety stock levels.

Avg. usage [units] A	Safety stock [units] B=C-A	Re-order Points C	Stockout [units] D	Stockout Cost E=D 5 5	Probability F=given	Expected Stockout G=E 5 F	Holding Cost H= B 5 1	Total Cost TC=G+H
240	180	420	0	0	0	0	180	180
240	120	360	60	300	0.07	21	120	141
240	60	<b>300</b>	120 60	600 300	0.07 0.08	42 24=66	60	<b>126</b>
240	0	240	180 120 60	900 600 300	0.07 0.08 0.20	63 48 60=171	0	171

**How the probability can be ascertained?**

Take the example given below, in which 240 units have a probability of 0.30., i.e., 0.30 may have been ascertained as follows: 52 weeks  $5 \times 0.30 = 15.6$  weeks that means out of 52 weeks in a year 240 usage units has arose for 15.6 weeks. Similarly, computations can be made for 300, 340, 420, 65, 125, 185 units respectively.

**When the cost of a stockout plus cost of holding the safety stocks are minimized?**

By using probability theory we can ascertain when the cost of a stockout plus cost of holding the safety stocks are minimized. Let me illustrate the process:

**Example.** The total usage for an item for stock over a 2 week lead time is expected to be as follows:

Usage[units]	65	125	185	240	<b>300</b>	<b>360</b>	<b>420</b>
Probability	.07	.16	.12	.30	.20	.08	.07

**Assume that the stockout cost is Rs.5 p.u and holding cost is Re.1 p.u**

**Answer:** the avg.usage during the 2 week lead time is 240. [Because it has more probability of .30]

If the firm carries no safety stock, the re-order level will be set @ 240 units.

There will be no stockouts if actual usage is 240 units or less. However if usage is more than 240 units i.e. say 300 units then 60 units is stockout. And the probability of this occurring is 0.20. If usage goes to 360 then 120 units is stockout—probability of this is 0.08. Similarly for 420 units—prob=0.07.

**Given,** the **stockout cost is Rs.5 p.u** and **holding cost is Re.1 p.u.** then expected costs for various stocks is given in the box (see top).

As we have said before if actual usage is less than or equals 240 units then there will be no stock out situation. So we should take the options of usage above 240 units i.e as in the problem 420, 360, 300 are the options.

So, **first situation,** if you re-order when 420 units is in stock,

then you keep a safety stock of 180units i.e as you know the formula

$$\begin{aligned} \text{Re-order Point} &= \text{Average usage} + \text{Safety stock} \\ &= 420 \quad [240 + \text{Safety stock}] \end{aligned}$$

If you have 420units in stock there will be no stock out situation because you have stock of maximum usage. But there will be holding cost of 180 units  $\times$  Rs.1 =Rs. 180. were the total cost incurred if you have safety stock of 180units will be Rs.180 only, as there is no stockout costs.

**2<sup>nd</sup> situation,** if you re-order at 360units, then you keep safety stock of 120units, but there is a chance of stockout situation when actual usage goes to 420units stockout units is 60 but the chance of occurrence is only 0.07. So the expected stockout costs is 60unit  $\times$  Rs.5  $\times$  0.07 = Rs.21. and holding cost is Rs.120  $\times$  Re.1 = Rs.120 therefore total cost incurred if you have safety stock of 120units is Rs.141.

**3<sup>rd</sup> situation,** if you re-order when stock is at 300 units, then you keep safety stock of 60units, but there are two chances of stockout situation – one is if actual usage goes to 420 units and other is if actual usage goes to 360 units. In the first chance there will be stockout of 120 units and the chance of occurrence is 0.07 so the costs works out to 120  $\times$  5  $\times$  0.07 = Rs.42. In the second chance there will be stockout of 60 units and the chance of occurrence is 0.08 so the costs works out to 60  $\times$  5  $\times$  0.08 =Rs.24 therefore total stockout costs works out to Rs.42 + Rs.24 = Rs.66. The holding cost is 60 units  $\times$  Rs.1= Rs.60 therefore total cost incurred if you have safety stock of 60units is Rs.126.

**Similarly** you can work out for last situation re-ordering at 240units. That’s works out to total cost of Rs.171.

**[note: the above sum is worked with only one number of order. But in sum you can have more than one order. Then you should multiply No. of orders to get expected stockout costs]**

From the above table, we can say that, when Re-order point is 300 units the stockout cost & holding cost is MINIMUM. So it is better to have safety stock of 60 units. [300 – 240] □

## Working Capital Management

GBK Prasad and Dr. SC Rastogi

Firms need cash to pay for all their day-to-day activities. They have to pay wages, pay for raw materials, pay bills and so on. The money available to them to do this is known as the firms working capital. The main sources of working capital are the **current assets** as these are the short-term assets that the firm can use to generate cash. However, the firm also has **current liabilities** and so these have to be taken account of when working out how much working capital a firm has at its disposal.

Working capital is therefore:-

$WC = \text{current Assets} - \text{current liabilities}$

Thus working capital is the same as net current assets, and is an important part of a firm's balance sheet. It is vital to a business to have sufficient working capital to meet all its requirements. Many businesses have gone under, not because they were unprofitable, but because they suffered from shortages of working capital.

### Working capital Cycle

Working capital is vital to a business. They have to have funds available to pay their day to day bills, wages and so on. The working capital is made up of the **current assets** net of the **current liabilities**. It is very important to a company to manage its working capital carefully. This is particularly true where there is a substantial time lag between making the product and receiving the money for it. In this situation the company has paid out all the costs associated with making the product (labour, raw materials and so on) but not yet got any money for it. They must therefore ensure they have enough **cash** to do this.

The way working capital moves around the business is modelled by the **working capital cycle**. This shows the cash coming into the business, what happens to it while the business has it and then where it goes. A simple working capital cycle may look something like:

Between each stage of this working capital cycle there is a time delay. For some businesses this will be very long where it takes them a long time to make and sell the product. They will need a substantial amount of working capital to survive. Others though may receive their cash very quickly after paying out for raw materials etc., they will need less working capital.

The above is a traditional view of working capital. What the authors propose is an alternate method of calculating working capital for any type of industry and also determine how much

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of the working capital is going to be financed thru long term funds. So far the theory developed says that working capital to be financed thru long term funds be defined



as permanent current assets and temporary/seasonal requirements to be financed thru short-term funds. In the book on Management finance by Varanasy S Murty, the author proposes a way of calculating the working capital required in the business using the operating cycle concept. The formula is

$$WC = \text{Operating cycle} \left( \frac{1 - z}{5} \right) \text{Sales} - D$$

Where

S = Sales per day

Z = Net profit margin

D = Depreciation per day

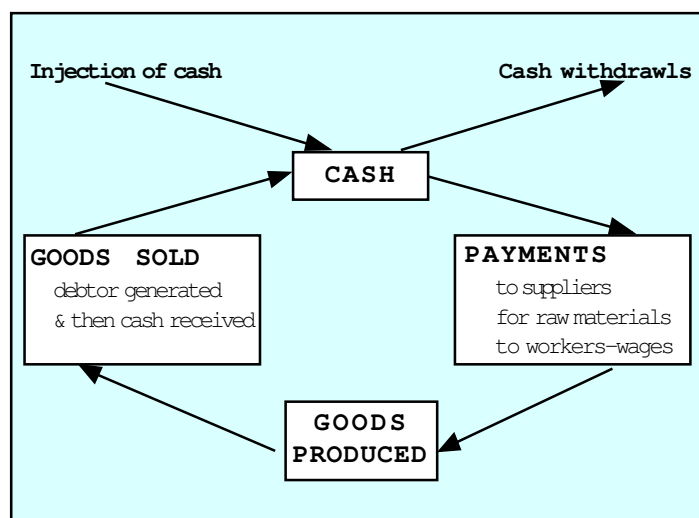
The above formula does not consider the effect of vendor payment terms on the working capital required and therefore, the authors propose this method of calculation as superior and provides significant insight into the company's requirement of working capital.

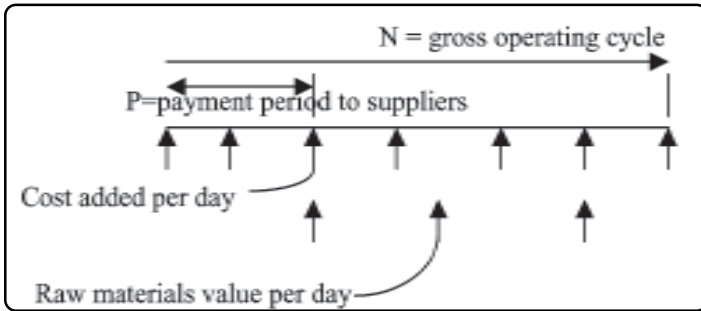
Defining

R M = raw materials consumption per day

Cost added = cost added in business per day (other than depreciation)

Working capital required can be estimated as





$$WC = RM \ 5 \ (N - p) + \text{cost added } 5 \ N$$

$$\text{Defining } \alpha = \frac{\text{Cost added}}{RM}$$

We can write it as:

$$W \ C = RM \ 5 \ N \ (1 + \alpha) \ -- \ RM \ 5 \ p$$

Further this can be written as

$$W \ C = RM \ 5 \ N + RM \ 5 \ (N \ 5 \ \alpha \ -- \ p) \ \dots \dots \dots \ 1$$

As one can see the equation 1 has two elements and the first element depends on type of company and the second element depends on vendor payment terms policy of the company. The second element can be eliminated if we fix payment terms as

$$P = N \ 5 \ \alpha \ \dots \dots \dots \ 2$$

If we exceed this cutoff point in terms of payment terms to vendors, the working capital requirement can be brought down substantially. Therefore this cut off point is important.

Another insight that this model gives if we fix

$$P = N \ 5 \ (1 + \alpha) \ \dots \dots \dots \ 3$$

The theoretical working capital becomes zero, therefore this is another cut off point that companies can use to plan their working capital and decide on the vendor payment terms to supplier.

**Comparison of Working Capital Management of Indian Firms**

	Mahindra & Mahindra	Telco	Ranbaxy	Dr. Reddy's
Raw material conversion period	24 days	16 days	74 days	77
WiP conversion period	3 days	6 days	21 days	38
FG conversion period	16 days	27 days	35 days	17
Debtors conversion period	52 days	38 days	96 days	104
Current payment period	108 days	119 days	79 days	141
Cost added (Rs. Croes)	1000	2243	1100	686
Raw materials consumption (Rs crores)	2500	5338	1000	332
Payment terms suggested by model	38 days	37 days	274 days	488 days
Theoretical working capital required (Rs. Crores)	170	67	1083	402
Actual working capital cash+inventories+ receivables-creditor) Rs. in Crores	443	617	1153	1175
Working capital efficiency	0.38	0.14	0.92	0.34
Payment terms to make working capital ZERO	142 days	124 days	523 days	725 days

Another insight this model gives is that we can classify industries as of two categories:

Industries wherein **cost added is < raw materials consumed** such as automobiles and another industry as **cost added is > raw materials consumed** such as pharmaceuticals. Based on the above equation 1, the decision to fix payment terms to suppliers for both types of industries can be decided. In the industry category 1, the payment terms to suppliers would be less than gross operating cycle and can be fixed by equation 2 and a feasible and practical decision can be taken for these types of industries.

For the industry type 2, the formula suggested by equation 2 gives the vendor payment terms should be fixed at greater than gross operating cycle. This becomes a problem when gross operating cycle itself is a high figure. Therefore, what one can draw the inference is that for these types of industries payment terms have to be longer and fixed on some practical considerations. A comparison of the model working for Automobiles and Pharmaceuticals industry wherein 2 companies from each type have been analysed is reproduced below:

The table below suggests a way of calculating working capital efficiency by calculating a ratio  $WC_{th} / WC_{act}$ . From the table it can be seen that even reputed companies are operating at different levels of efficiency in their working capital management.

What the authors propose is for any company in equation 1,  $RM \ 5 \ N$  is a constant term and this is the amount that has to be financed out of long-term funds. And the second term is one which should be financed out of short term funds. If the above concept is accepted, one can determine the conditions when long term funds can be greater than short term financing of working capital in the above equation.

We want the conditions when

$$RM \ 5 \ N > RM \ 5 \ (N \ 5 \ \alpha - p)$$

This leads to

$$N > \frac{p}{\alpha - 1}$$

Therefore we can always select  $p$  in such a way that the above working capital can always be financed more thru long term funds rather than short term funds even in industries where cost added > RM.

The above approach, authors feel is a better way to estimate the long term funds requirement to finance working capital and puts us on a solid ground and a practical way of achieving this can be seen to exist. □

# Options – Basic Concepts and the Values

Dr. S.Z.H. Zaidi

## Introduction

The last few years have witnessed dramatic changes in the landscape of Indian capital market. The introduction of option trading is one of the important milestone in this direction. Even though option trading had been prevalent in a limited way during the ancient Greece and Rome. However, in India, derivatives trading on NSE commenced on June 12, 2000 with futures trading on S & P CNX Nifty Index. Subsequently the product base has been increased to include trading in options on S & P CNX Nifty Index, futures and options on CNX IT Index, futures and options on single stocks (118 stocks with effect from May 27, 2005) and futures on interest rates. The turnover in the derivatives segment has witnessed considerable growth since inception.

Options have proved to be a good risk management mechanism now. An attempt has therefore been made here to explain the concept of options and their relevance in a lucid way keeping in view the requirements of students' fraternity. It is worth mentioning that questions on basic concepts of options have appeared in the examination previously.

## What is an option?

An option is a legal contract in which the writer of the contract grants to the buyer, the right to purchase from or sell to the writer a designated instrument or a scrip at a specified price within a specified period of time.

For instance a writer of an option writes a contract which conveys or grants to the buyer a right to buy 100 shares of Prism Ltd. from him i.e. the writer @ Rs. 100 per share. This option is called a call option and designated as 100 Prism 100 call.

Similarly, if a writer writes an option which grants to the buyer a right to sell to the writer 100 shares of Prism Ltd. @ Rs. 100 per share such an option is called a put option and is designated as 100 Prism 100 put.

An option contract must have following four *essentials*:

1. The name of the company on whose stock the option contract has been written.

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2. The quantity of the stock required to be delivered in the case of exercise of the option.
3. The price at which the stock would be delivered, called the exercise price or strike price.
4. The date on which the contract expires, called the expiration date.

## Difference between stock and option

The basic difference between stock and the option is that the stock bestow upon the rights of ownership to an individual in the company while options are just contracts that gives the right to buy or sale the stock at a specific price by a specified date. It is important to remember that there are always two sides for every option transaction, a buyer and a seller. So for every call or put option purchased, there is always some one else selling it.

## Basic concepts of option

### Call and put options

There are basically two types of options known as call and put options. Call option grant a right but not the obligation to purchase an underlying security at the strike price at any time before the expiration of option whereas in a put option, you have the right but not the obligation to sell a stock at the strike price at any time before the expiration date.

Options are basically – *American option* and *European option*. In the case of former style, option can be exercised at any time between the date of purchase and the expiration date whereas in the latter case i.e. the European style, option can only be exercised on the expiration date. Most of the exchange traded options are American style whereas many index options are European style.

The *strike price* (also known as exercise price) is the price at which the transaction is to be executed between the writer and the buyer of an option. When the strike price of a call option is above the current price of the stock, the call is *out of the money* and when the strike price is below the stock price it is *in the money*. Put options are exact opposite, being out of money when the strike price is below the stock price, and in the money above it.

**Premium:** The price of an option is called its premium. The

buyer of an option cannot lose more than the initial premium paid for the contract, irrespective of the fact what happens to the underlying security. So the risk to the buyer is limited to the amount paid for the option. The profit potential, on the other hand, is, however, unlimited. The writer of an option in return for the premium received from the buyer, assumes the risk of having to deliver (in case of call option) or taking delivery (in case of put option) of underlying security. Unless that option is covered by another option or a position in the underlying security, the seller's loss can be open ended, meaning thereby that the seller can lose much more than the original premium received by him. The premium of an option is usually a function of a number of variables like current stock price, strike price, time to expiration, volatility of stock and the interest rates etc.

Options can be *exchange traded* as well as they can be traded *over the counter (OTC)*. Exchange traded options are standardised and traded on organized exchanges whereas over the counter options are customized.

In option terminology *going long* a stock means buying the stock, *selling long* means that the seller owns the stock he is supposed to deliver to the buyer. *Selling short* means that the seller does not own the stock he is supposed to deliver and will have to borrow the stock now for delivering to the buyer and buy the stock later to set off the borrowing.

An option contract is called *covered* when the writer owns the underlying asset or has another offsetting option position. In the absence of one of these conditions, the writer is *exposed* to the risk of having to fulfill the contractual obligations by buying the asset at the time of delivery at an unfavourable price.

The call writer may have to purchase the underlying asset at a price i.e. higher than the strike price. The put writer may have to buy the asset from the holder at a price that creates a loss. When they face such a risk, writers are set to be *uncovered or naked*.

Call writers are generally considered to be covered if they have any of the following positions.

- (1) A long position in the underlying asset.
- (2) An escrow receipt from the bank.
- (3) A security i.e. convertible into requisite number of shares of the underlying security.
- (4) A warrant exercisable for requisite number of shares of the underlying security.

- (5) A long position in a call on the same security that has the same or a lower strike price and that expires at the same time or later than the option being written.

As far as the covered put is concerned there is only one way for put writers to be covered. They must own a put on the same underlying asset with the same or later expiration month and the same or higher strike price than the option being written.

*Intrinsic value* of an option and the *Time value* of an option are primary determinants of an option price. By being familiar with these terms and knowing how to use them, any one will find himself in a much better position to choose the option contract that best suits his particular investment requirements.

*Intrinsic Value:* This is the value that any given option would have if it were exercised today. It is defined as the difference between the option's strike price (X) and the stock's actual current price (CP). In the case of a call option, you can calculate this intrinsic value by taking  $CP - X$ . If the result is greater than zero (in other words, if the stock's current price is greater than the option's strike price), then the amount left over after subtracting  $CP - X$  is the option's intrinsic value. If the strike price is greater than the current stock price, then the intrinsic value of the option is zero- it would not be worth anything if it were to be exercised today (please note that an option's intrinsic value can never be below zero). To determine the intrinsic value of a put option, simply reverse the calculation to  $X - CP$ .

To illustrate, let's say Prism Ltd. stock is priced at Rs.105. In this case, a Prism 100 call option would have an intrinsic value of Rs. 5 ( $Rs.105 - Rs.100 = Rs. 5$ ). However, a Prism 100 put option would have an intrinsic value of zero ( $Rs.100 - Rs.105 = -Rs.5$ ) since this figure is less than zero, the intrinsic value is zero. Again, intrinsic value can never be negative. On the other hand, if we were to look at a Prism put option with a strike price of Rs. 120, then this particular option would have an intrinsic value of Rs.15 ( $Rs.120 - Rs.105 = Rs.15$ ).

*Time value:* This is the second component of an option's price. It is defined as any value of an option other than its intrinsic value. Looking at the example above, if Prism is trading at Rs.105 and the Prism 100 call option is trading at Rs.7, then we would say that this option has Rs.2 of time value ( $Rs.7$  option price -  $Rs.5$  intrinsic value =  $Rs.2$  time value). Options that have zero intrinsic value are comprised entirely

of time value. Time value is basically the risk premium that the seller requires to provide the option buyer with the right to buy / sell the stock up to the expiration date or this component may be regarded as the *insurance premium* of the option. This is also known as extrinsic value. Time value decays over time. In other words the time value of an option is directly related to how much time an option has until expiration. The more time an option has until expiration the greater the chance of option ending up in the money.

In nutshell we can say that intrinsic value and time value are two of the primary determinants of an option price. Intrinsic value can be defined as the amount by which the strike price of an option is in the money. It is actually the portion of an option's price that is not lost due to the passage of time. The time value of a stock option is always somewhere between zero and exercise price of the option.

The following equations will enable you to calculate the time and intrinsic value of call and put options.

#### Call options

Intrinsic value = Underlying stock's current price - call strike price

Time value = call premium - intrinsic value

#### Put options

Intrinsic value = put strike price - underlying stock's current price

Time value = put premium - intrinsic value

### Current scenario in India

In the global market NSE ranks first in terms of number of contracts traded in the single stock futures, second in Asia in terms of number of contracts traded in equity derivatives instruments. Since inception, NSE established itself as the stock market leader in this segment in the country with more than 99% market share.

The trading terminals of Futures and Options (F & O) segment are at present available in 316 cities as at the end of March, 2005. Besides, the trading can also be carried through the internet by investors. While the index options are European style, stock options are American style.

At any point of time there are three contract months available for trading, with 1 month, 2 months and 3 months to expiry. These contracts expire on last Thursday of the expiry month and have a maximum of 3 month expiration cycle. A new contract is introduced on the next trading day

Nifty Index Level	Strike Interval	Scheme of strikes to be introduced (ITM-ATM-OTM)
Upto 1500	10	3-1-3
>1500 upto 2000	10	5-1-5
>2000 upto 2500	10	7-1-7
>2500	10	9-1-9

(Source: [www.nseindia.com](http://www.nseindia.com))

following the expiry of the near month contract. All the derivatives contracts are presently cash settled.

### Introduction of strike prices for option contracts

NSE introduces option strikes on a daily basis based on the price of the underlying.

With regard to options on stocks and CNX IT index the Exchange provides a minimum of seven strike prices of every option type (i.e. Call & Put) during the trading month. At any time, there are at least three strikes in-the-money (ITM), three strikes out-of-the-money (OTM) and one strike at-the-money (ATM).

The number of strikes provided in options on Nifty index is related to the range in which previous day's closing value of Nifty index falls as per the table (See box).

### Trading Value

The F & O segment reported a total trading value (notional) of Rs. 2,547,053 crores during 2004-05 as against Rs. 2,130,649 crores, a rise of more than 19.54% in the past one year. The trading volumes in the F & O segment indicate that futures are more popular than options; contracts on securities are more popular than those on indexes; and call options are more popular than put options.

The F & O segment provides a nationwide market. The turnover of the top '5' and '10' members accounted for 24.39% and 40.51% respectively in 2004-05 in the Futures segment. However, the turnover of the top '5' and '10' members in the options segment accounted for 39.26% and 60.43% respectively in the same period.

All futures and options contracts are cash settled i.e. through exchange of cash.

After completion of daily settlement computation, all the open positions are reset to the daily settlement price. Such positions become the open positions for the next day.

# Cost and Management Accounting : A Historical Perspective

R K Srivastava

## Abstract

The theory of Cost Accounting has seen rapid changes in the 19<sup>th</sup> and the 20<sup>th</sup> century. Academia world over have argued over the relevance of cost and management accounting for decision-making and product costing purposes. They contend that while management accounting was an important tool in the nineteenth and twentieth centuries, its importance in terms of both scope and objectives has been dominated by the requirements of financial accounting, with product costing systems increasingly concentrating on manufacturing costs for stock valuations. It is widely believed that the fall of the UK and the US industry during the 1980's and the 1990's was caused due to wrong Product Costing, which provided with misleading inputs to managers thereby resulting in wrong and detrimental decision making.

The focus of this article is to review the current scenario from a historical perspective so as to help students understand the need of the emergence of modern concepts like Target and Activity Based costing. The article considers four paradigms that cover the history of cost and management accounting in the context of both product costing and the determination of selling price.

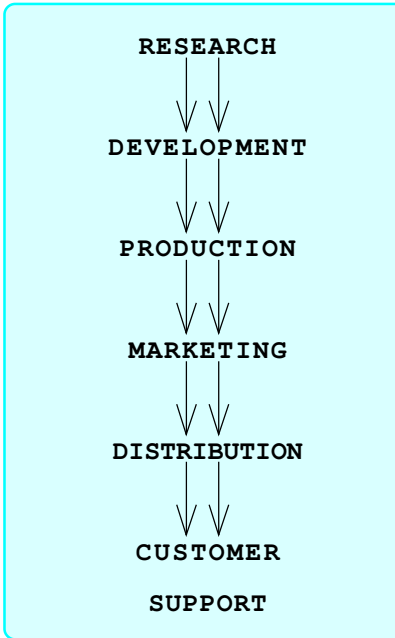
### The traditional framework (Paradigm 1 and 2)

Since the time of industrialisation, Cost and Management Reporting has always been the responsibility of either Cost or Financial Accountants or both. Apart from the statutory Balance Sheet, Profit and Loss Account and the Cash Flow statements, the financial accountants of companies would provide other detailed reports to the management using the same set of historical data. However allocation and apportionment of expenses over cost centres and finally their absorption on the Finished Product continued to be the responsibility of the Costing professionals. Many companies adapted the Integrated Model to combine the Costing and the Accounting functions and get real time information, which would be of a greater use than the historical data provided by financial accounts.

However, with the advent of financial audit (early 1900s)

*The author is Deputy Director, ICAI.*

and its increasing importance ever since, product costing systems have increasingly concentrated on the production portion of the value chain (See box),



This is also understandable since during the first half of the nineteenth century and perhaps till a couple of decades later, manufacturing costs accounted for the bulk of total costs incurred by the industry. The reason being the lack of competitive markets resulting in less advertising and distribution costs coupled with very little marketing and customer support. Manufactures worked in a monopolistic or a near monopolistic environment and so did not require incurring large quantum of expenditure on the above-mentioned functions. With most of the money being expended on the production function, reports provided by financial accountants for inventory valuation purposes gave enough information to the management about the majority of expenses being incurred by the company. Many of the other

costs incurred in the other than production function of the value chain were considered discretionary and since the total quantum of such costs would not be huge, frequently they were excluded from decision-making purposes.

However, manufacturing costs computed then were typically characterised by simplistic assumptions, the use of 'blanket' overhead rates and simple labour overhead recovery bases being the common practice. This would result in wrong product costs, the detrimental effect of which was understood only during times of fierce competition and growth, beginning 1980s.

### The traditional era of cost and management accounting

The traditional era of cost accounting can be divided into the following two phases;

- ◆ Pre 1940,s – Costs were classified as Direct Costs and Manufacturing overheads. **(Paradigm 1)**
- ◆ Post 1940,s– Costs were classified as Direct Costs, Fixed overheads and Variable overheads. **(Paradigm 2)**

**CONTENTIOUS ISSUES (Paradigm 1)**

A pre 1940 Product Cost Sheet appeared to be as shown below;

**Pre 1940 Cost Sheet (Paradigm 1)**

Cost Sheet	Rs per Unit
Direct materials	xx
Direct labour	xx
Manufacturing overhead	xx
Marketing and administrative overhead	xx
<b>Total cost per unit</b>	<b><u>xx</u></b>
Desired profit (mark-up)	xx
<b>Target selling price per unit</b>	<b><u>xx</u></b>

There are two issues of contention which immediately cross ones mind on looking at the cost sheet shown above. They are;

1. What volume of activity should be used to project overheads so as to arrive at unit cost?
2. What should be the criteria to determine desired profit?

Possible answers to the volume of activity<sup>#</sup> question, which needs to be addressed to determine the total unit cost, usually lean in the direction of expected volume, normal level of production or capacity of the plant.

The answer to the second question is generally subjective. However, the use of 'cost of capital' concepts remains the most widespread.

# In case one looks carefully at the Cost Sheet drawn above, it shall be clear that whose ever prepares the Cost Sheet has got enough information on the volume of activity to be conducted by the concerned company, because only if this information is available can one actually predict the amount of manufacturing overheads to be incurred in a future period. In a competitive market, it may be safely argued that one can only know the volume of activity to be performed by having in his mind a tentative Market Price. Strangely, however, this is one of the primary objective of a Cost Sheet. Similarly the issue of desired profit, the calculation and computation of which is extremely subjective and hence contentious.

**Post 1940 Cost Sheet (Paradigm 2)**

As mentioned above, there are very subtle differences in the Pre and Post 1940s period. Unlike Pre 1940s, post 1940 Cost Sheets were characterised by the fixed and variable concepts. By doing so, they answered, **to a certain extent**, one of the contentious issues mentioned during the Pre 1940 era, that is;

◆ Since variable cost of units is determined by engineering

standards and other analytical techniques, they do away with the volume of activity question, which essentially then pertains to fixed costs.

A post 1940 Product Cost Sheet appeared to be as shown below;

Cost Sheet	Rs per Unit
<b>Variable costs</b>	
Direct materials	xx
Direct labour	xx
Variable manufacturing overhead	xx
Variable marketing and administrative	xx
<b>Total variable cost per unit</b>	<b><u>xx</u></b>
<b>Fixed cost</b>	
Fixed manufacturing overhead	xx
Fixed marketing and administrative	xx
<b>Total fixed cost per unit</b>	<b><u>xx</u></b>
<b>Grand total cost per unit</b>	<b><u>xx</u></b>
Desired profit (mark up)	xx
<b>Target selling price per unit</b>	<b><u>xx</u></b>

The post 1940 era is popularly known as the era of 'Cost Volume Profit Analysis', in which the manufacturing overheads were segregated into fixed and variable. Whereas variable overheads could be identified with the production pattern with ease, the fixed overheads needed to be imputed over the products. This used to be done by identifying appropriate Cost Centres and Overhead absorption rates. Fixed manufacturing overheads were initially allocated over the Cost Centres and then finally absorbed over the output at the rates, which were pre-established. The overhead rates were established considering the maximum output, which could be achieved by the specific cost centres as compared to the budgeted costs, which would be incurred for that level of activity. The result was, that in case a company did not produce to potential, certain amount of these fixed overheads would not be absorbed over the products and hence remain unabsorbed. Such overheads were subsequently charged to the Profit and Loss Account and also provided the management with information about the productivity of the workers on the shop floor. However, Product Costing done on the basis of imputing fixed costs gives approximate results and is only useful in case the product has a long life cycle in the market. In the present competitive scenario, where innovation is the rule of the day, product life cycles have shortened and the competition has increased amongst companies at an unprecedented level. Traditional costing may not be appropriate today as what it was when the market conditions were different.

**Activity Based Costing (Paradigm 3)**

The contentious issue of volume of activity remained in the

post 1940 era although it then concerned only the fixed overheads. As pointed out above, the concept of imputing fixed cost per unit had its own shortcomings.

To a large extent, such anomalies are done away with the use of Activity Based Costing (ABC). A Cost Sheet prepared with ABC concepts is shown below;

<b>Cost Sheet (ABC)</b>	<i>Rs per Unit</i>
<b>Variable costs</b>	
Direct materials	xx
Direct labour	xx
Variable manufacturing overhead	
Variable with number of units	xx
Variable with product complexity (number of batches)	xx
Variable with product diversity (number of products)	xx
Variable marketing and administrative	xx
Total variable cost per unit	<u>xxx</u>
<b>Fixed cost</b>	
Fixed manufacturing overhead	xx
Fixed marketing and administrative	xx
<b>Total fixed cost per unit</b>	<b>xx</b>
<b>Grand total cost per unit</b>	<b><u>xxx</u></b>
Desired profit (mark up)	xx
<b>Target selling price per unit</b>	<b><u>xxx</u></b>

A careful study of the differences in the post 1940 era and the Activity Based Cost Sheet shows that ABC recognises two additional variable costs and is essentially designed to improve the accuracy of the total unit cost thereby impacting favourably the fixation of selling price. These two additional variable costs are as follows;

- ◆ Costs, which vary with product complexity, such as number of batches.
- ◆ Costs that vary with product diversity, such as number of products.

Although, there are many critics of ABC who contend that the technique is nothing but an improvement over the traditional concepts, it is easy to see how ABC would be a better tool during times when customers become demanding in terms of 'features' of products because of which companies have to cater to slightly different types of production processes for essentially the same product. The Textile Machinery and Picture Tube industry in India faced such a situation during the mid 1990s when the government had allowed foreign companies to enter the Indian markets and the import duties

on second hand goods, SKDs and CKDs were reduced drastically. Customers then had more choices; product diversity and complexity were the need of the hour. The benefits of ABC during such times are immense.

**Market driven standard costs (Paradigm 4)**

Unlike traditional costing concepts where a target selling price is established after computing the cost of a product, paradigm 4 uses the selling price it believes the market will allow in order to determine the allowable cost. Hence, the allowable or target cost per unit is a market driven standard cost that has to be met if the desired profit are to be achieved.

Cost per unit under paradigm 4 is computed as follows;

<b>Target Cost Sheet</b>	<i>Rs per Unit</i>
Selling price (prevailing in a competitive setting)	Xx
Less desired profit	xx
Target or allowable cost	xx

In Target Costing what counts is the need to produce at an allowable cost. This idea may mean that now the distinction between fixed and variable components is immaterial. It also implies that in case one intends to continuously improve, this allowable target cost should be reduced over time. Such reductions shall need an empowered workforce because it is the one, which is nearest to the action and so in the best position to lead towards a path of continuous improvement.

**Conclusion**

The scope and objective of cost and management accounting has changed over a period of time. New tools and techniques like ABC and Target Costing have been introduced, keeping in mind the changing economic environment, which has increased competition. Activity Based Costing is a substantial improvement over the traditional costing techniques because of its identifying more variability in expenses incurred in the production process. However, it is unable to do away with the contentious issue of computing the 'desired profit'. In today's competitive environment, Target Costing, with its emphasis on market driven costs is perhaps the best way to survive productively.

**References**

1. Johnson and Kaplan – Relevance lost : the rise and fall of management accounting.
2. Cooper, R(1996)– Activity Based Costing and the lean enterprise : Journal of Cost Management.
3. William L.Ferrara, CPA, Management Accounting (USA) : Cost/Management Accounting : the 21 st century paradigm. □

## Announcement – Applicability of Accounting Standards to an Unlisted Indian Company which is a Subsidiary of a Foreign Company Listed Outside India

1. The Council of the Institute of Chartered Accountants of India has issued an Announcement (see '*The Chartered Accountant*', November 2003 (pp. 480-489)) on 'Applicability of Accounting Standards' with a view to lay down the scheme of applicability of Accounting Standards to Small and Medium Sized Enterprises (SMEs). As per the said scheme, all accounting standards are applicable to Level I enterprises. Level I enterprises, *inter alia*, include (i) enterprises whose equity or debt securities are listed whether in India or outside India, and (ii) holding or a subsidiary of a Level I enterprise.

2. With regard to above, an issue has been raised as to whether, as per the above scheme, a foreign company which is incorporated and listed outside India would also be considered as a Level I enterprise and consequent to this, whether an unlisted Indian company, which is a subsidiary of this foreign company, would become a Level I enterprise merely because of it being a subsidiary of the said foreign company.

3. It is clarified that, in the above-stated scheme, the term 'enterprise' includes all entities that are required to prepare their

financial statements as per the Indian GAAPs. Accordingly, all Indian entities, i.e., the entities which are incorporated in India, are covered in the said scheme. The scheme also covers those foreign entities which are required to prepare their financial statements as per the Indian GAAPs. Thus, in case a foreign company, which is incorporated and listed outside India, is required to prepare its financial statements as per the Indian GAAPs, it will be considered as a Level I enterprise. In such a case, the Indian company, which is a subsidiary of the aforesaid foreign company, would also be considered as a Level I enterprise for the reason that it is a subsidiary of another Level I enterprise. In case the parent foreign company is not required to prepare its financial statements as per the Indian GAAPs, its Indian subsidiary would not be considered to be a Level I enterprise provided it does not meet any other criteria for becoming Level I enterprise as per the said scheme. Thus, in such a situation, the status of the Indian company under the above scheme will be determined independent of the status of its parent foreign company.

### Western India CA Students' Regional Conference – Nagpur

<b>Date:</b>	3 <sup>rd</sup> & 4 <sup>th</sup> December, 2005
<b>Venue:</b>	IMA Hall, North Ambazari Road, Nagpur
<b>Registration Fees:</b>	Rs. 500
<b>Chief guest:</b>	Shri T.N. Manoharan, Vice-President, ICAI

Students are requested to register as delegate for C.A. Students' Regional Conference.

Interested Students may submit papers on the subjects given below on paper and on electronic Media at the earliest.

List of proposed topics:

1. Accounting & Auditing
2. Corporate Law & Finance
3. Direct & Indirect Taxes
4. Economics
5. Education & Training
6. About the Profession

**Cultural Evening By Students on 3<sup>rd</sup> Dec. 2005**

For further details please contact.

Chairman Nagpur Branch:	Shri Anil Mardikar Mobile 9422105733
Chairman WICASA:	Shri P.R. Risbud Mobile-9823148503

### Third Virtual Class on "Business Taxation"

The Board of Studies conducted its third virtual class on business taxation through twenty one Reliance Webword centers.

Shri Jayant N. Shah, Chairman Board of Studies highlighted the benefits of virtual class in his opening remarks from Nagpur centre and appreciated the efforts of Board of Studies to bring the expertise of eminent faculties to the door steps of the students through this technology.

Mr. T. N. Manoharan, Vice-President of the ICAI, in his special address from Cochin, outlined the benefits flowing from the virtual classes which were very similar to personal class teaching. He exhorted the students to take the advantage of these important value additions made by the Board of Studies for the benefit of students.

Dr. V. K. Singhania, the faculty member in taxation of Shri Ram College of Commerce and tax management consultant conducted the class on business taxation from Delhi. He covered depreciation under section 32, scientific research expenses under section 35, inadmissible expenses under section 40A, sums allowable on payment basis under section 43B and rebate under section 88E. After the lecture, several students participated in the ensuing inter-active session. More than thirty queries were fielded by students from all over the country which were appropriately addressed.

Mr. Manoj Fadnis, Vice-Chairman, Board of Studies gave the concluding remarks from Indore.

# Accounting Standards Interpretation (ASI) 29<sup>1</sup>

## Turnover in case of Contractors Accounting Standard (AS) 7, Construction Contracts (revised 2002)

### ISSUE

1. AS 7, Construction Contracts (revised 2002) deals, inter alia, with revenue recognition in respect of construction contracts in the financial statements of contractors. It requires recognition of revenue by reference to the stage of completion of a contract (referred to as 'percentage of completion method'). This method results in reporting of revenue which can be attributed to the proportion of work completed. Under this method, contract revenue is recognised as revenue in the statement of profit and loss in the accounting period in which the work is performed.

The issue is whether the revenue so recognised in the financial statements of contractors as per the requirements of AS 7 can be considered as 'turnover'.

### CONSENSUS

2. The amount of contract revenue recognised as revenue in the statement of profit and loss as per the requirements of AS 7 should be considered as 'turnover'.

### BASIS FOR CONCLUSIONS

3. The paragraph dealing with the 'Objective' of AS 7 provides as follows:

#### 'Objective'

The objective of this Statement is to prescribe the accounting treatment of revenue and costs associated with construction contracts. Because of the nature of the activity undertaken in construction contracts, the date at which the contract activity is entered into and the date when the activity is completed usually fall into different accounting periods. Therefore, the primary issue in accounting for construction contracts is the allocation of contract revenue and contract costs to the accounting periods in which construction work is performed. This Statement uses the recognition criteria established in the Framework for the Preparation and Presentation of Financial Statements to determine when contract revenue and contract costs should be recognized as revenue and expenses in the statement of profit and loss. It also provides practical guidance on the application of these criteria."

From the above, it may be noted that AS 7 deals, inter alia, with the allocation of contract revenue to the accounting periods in which construction work is performed.

4. Paragraphs 21 and 31 of AS 7 provide as follows:

"21. When the outcome of a construction contract can be estimated reliably, contract revenue and contract costs associated with the construction contract should be recognised as revenue and expenses respectively by reference to the stage of completion

of the contract activity at the reporting date. An expected loss on the construction contract should be recognised as an expense immediately in accordance with paragraph 35."

"31. When the outcome of a construction contract cannot be estimated reliably:

- a revenue should be recognised only to the extent of contract costs incurred of which recovery is probable; and
- b contract costs should be recognised as an expense in the period in which they are incurred.

**An expected loss on the construction contract should be recognised as an expense immediately in accordance with paragraph 35."**

From the above, it may be noted that the recognition of revenue as per AS 7 may be inclusive of profit (as per paragraph 21 reproduced above) or exclusive of profit (as per paragraph 31 above) depending on whether the outcome of the construction contract can be estimated reliably or not. When the outcome of the construction contract can be estimated reliably, the revenue is recognised inclusive of profit and when the same cannot be estimated reliably, it is recognised exclusive of profit. However, in either case it is considered as revenue as per AS 7.

5. 'Revenue' is a wider term. For example, within the meaning of AS 9, Revenue Recognition, the term 'revenue' includes revenue from sales transactions, rendering of services and from the use by others of enterprise resources yielding interest, royalties and dividends. The term 'turnover' is used in relation to the source of revenue that arises from the principal revenue generating activity of an enterprise. In case of a contractor, the construction activity is its principal revenue generating activity. Hence, the revenue recognised in the statement of profit and loss of a contractor in accordance with the principles laid down in AS 7, by whatever nomenclature described in the financial statements, is considered as 'turnover'.

**ASI (Accounting Standard Interpretation) 3 on AS 22 'Accounting for Taxes on Income' and ASI 20 on AS 17 'Segment Reporting' have been revised recently by the Council of the Institute of Chartered Accountants of India. 'Guidance Note on Accounting for Fringe Benefits Tax [GN (A) 20 (Issued 2005)]' has also been issued by the Institute of Chartered Accountants of India to provide guidance on accounting for fringe benefits tax. For the full text of the revised ASI 3 and ASI 20 and Guidance Note on Accounting for Fringe Benefits Tax, students are advised to refer the August issue of The Chartered Accountant Journal. Alternatively, they can also visit the Institute's website ([www.icai.org](http://www.icai.org)) where the information is hosted on the 'Resource' section.**

<sup>1</sup> The authority of this ASI is the same as that of the Accounting Standard to which it relates. The contents of this ASI are intended for the limited purpose of the Accounting Standard to which it relates. ASI is intended to apply only to material items.

## 250 Hours Compulsory Computer Training Programme

### Revised Guidelines Applicable for Students Joining from October 1st, 2005

The Board of Studies has designed a new scheme for organizing 250 Hours Compulsory Computer Training Programme w.e.f. 1.10.2005. The salient features of the new scheme are as given below:

1. The minimum duration to complete the computer training is three months. Two options for undergoing the programme are as follows:

**Option I :** Duration – Three months (classes may be conducted 4 hours/day, 5 days/week)

**Option II:** Duration – four months (classes may be conducted 7 hours/day, on Saturday and Sunday)

2. Training will be organized in a batch system. A batch will be started only in the first week of each month.

3. There shall be four module tests.

4. Students will be allowed to appear for online examination only after completion of minimum duration of the course as well as all curriculum given in the prospectus and reference manual, i.e., after clearing the four Module Tests, submission of project and adherence to minimum attendance criteria of ninety percent.

5. Online examinations will be conducted on second Sunday of every month. Students fulfilling all the criteria stated in Point No. 4 above could appear for the final online exam. The examinations are generally conducted from 10 a.m., duration of which is 3 hours. Students are advised to contact their accredited training centres for further details in this regard.

#### Other important points to remember are:

- (i) Students should register for 250 Hours Compulsory Computer Training Programme while undergoing Professional Education (Course – I) or Professional Education (Course – II). It is advised that students may plan the computer training in such a manner that they are able to complete it well in advance of declaration of results of Professional Education (Examination – II).
- (ii) Students should also take care that they first register with the Board of Studies for 250 Compulsory Computer Training Programme by submitting the requisite application form. Once the application is found to be complete in all respects, a registration letter will be issued for undergoing the computer training. The students may note that the concerned Regional Office takes minimum 15 days to issue this letter. Thereafter, they can start their 250 Hours Compulsory Computer Training with any of the accredited training institutes/centres.

(iii) As there will be a batch system, students are advised to register with the authorized accredited institutions in advance.

(iv) Students are advised to take admission only in the listed accredited training institutes/centres. The updated list of accredited training institutes / centres is available on the website of the Institute, <http://www.icai.org/students/index.html>, in the prospectus and Reference Manual supplied to students registering for 250 Hours Compulsory Computer Training Programme. In case of any doubt or clarification, you may contact the concerned Regional Offices or Board of Studies at the given e-mail id: [bosnoida@icai.org](mailto:bosnoida@icai.org).

(v) The CCT Completion certificate will be issued by the concerned Regional Office within 25 days from the date of final online examination.

(vi) Many students face hardship on account of delay in their registration for articleship due to non-receipt of 250 Hours Compulsory Computer Training Completion Certificate. It is reiterated that completion of the computer training is a prerequisite for registration of the articleship. It is suggested that students may plan the computer training in such a manner that they are able to complete it well in advance of declaration of results of Professional Education (Examination – II). In case they fail to do so, there is a delay of at least 3 months if not more. Students should also keep in mind that the final online test is conducted once in a month. Thus, the time loss on account of non-completion of the computer training in time will be much more.

It is further clarified that **there is no change in the syllabus** at present for 250 Hours Compulsory Computer Training Programme in this new scheme, only the modalities of imparting training have been modified for implementation of the scheme in a simplified manner. It is again clarified that these guidelines are applicable to students joining the 250 Hours Compulsory Computer Training Programme on and from October 1<sup>st</sup>, 2005. For students registered prior to October 1<sup>st</sup>, 2005, the existing guidelines, wherein they are required to undergo computer training for a minimum duration of three and a half months and clear six module tests beside other conditions, will remain applicable. Students are advised to lodge complaints for difficulties faced in pursuing 250 Hours Compulsory Computer Training Programme with the accredited institutes / delay in getting Compulsory Computer Training Programme Completion Certificate/difficulties faced for appearing in the online examination at e-mail id [indu@icai.org](mailto:indu@icai.org).

### Online Examination

The next online Examination for 250 Hours Compulsory Computer Training Programme will be conducted on 20<sup>th</sup> November, 2005 at 10.00 AM. All those students who fulfil following requirements are eligible to appear for this examination :

1. Completed minimum three and half months computer training,
2. Cleared all six module tests
3. Submitted the project
4. Attained 90% attendance

Students are advised to contact their concerned accredited training institutes for further details. In case you face any difficulty regarding conduct of online examination at your training centre, please contact the concerned Regional Office. Alternatively, you can contact Mrs. Indu Arora at NOIDA office at e-mail address [indu@icai.org](mailto:indu@icai.org).

## Announcements

### 1. New Eligibility Test Paper Scheme

In order to improve quality of the answers submitted by the students to Postal/Sunday Test Papers, the Board of Studies emphasizes that students should be well prepared and attempt the test papers in an examination condition. Reviewing the time frame of the study period, the Board of Studies decided to reduce the number of Postal Test Papers to be submitted by a student as well as Sunday Tests to be appeared by PE-II and Final students which are given below:

Course	New Eligibility Test Paper Scheme	Old Eligibility Test Paper Scheme
PE (Course-I)	To submit and pass in 4 Postal Test Papers consisting of one test paper in each subject.	Students were required to answer two test papers in each of the four papers.
PE (Course-II)	To submit and pass in 6 Postal Test Papers or appear and pass in 6 Sunday Tests consisting of one test paper in each subject. Paper 3: Business laws and Corporate Laws and Paper 4: Cost Accounting and Financial Managements are not to be treated as separate subjects.	Students were required to pass in 10 test papers choosing at least one test paper in each of the 8 subjects (treating Paper 3: Business laws and Corporate Laws and Paper 4: Cost Accounting and Financial Management as separate subjects) and two additional papers of their choice.
Final Course	To submit and pass in 8 Postal Test Papers or appear and pass in 8 Sunday Tests consisting of one test paper in each subject.	Students were required to pass at least 8 papers per group, 16 papers for both the groups. The requirement are applicable to both Sunday Test Paper Scheme and Postal Test Paper Scheme

#### **New Eligibility Test Papers Scheme is applicable for May 2006 Examination and thereafter**

Physically handicapped students as defined in Para 6.4 of the Prospectus - Gateway to the Chartered Accountancy are required to submit only 2 Test Papers under the new eligibility scheme as stated above. Such students will be provided with a specially designed test papers by the respective Regional Offices. These specially designed test papers will be available on and from December 1, 2005.

Cut off dates for submission Postal Test Papers / appearance in Sunday Tests to become eligible to appear in May 2006 Examinations:

PE (Course-I) and PE (Course-II):	1st January, 2006
Final Course	31st January, 2006

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

Students seeking eligibility for appearing in May 2006 examination might have already submitted certain number of postal test papers. They will get full credit for such test papers, if qualify obtaining 45 marks in each of such test papers. They have to submit balance number of test papers only as per the New Eligibility Test Paper Scheme.

Similarly, PE (Course II) and Final Course students, who are under Sunday Test Scheme, seeking eligibility for appearing in May 2006 Examination might have already appeared in certain number of Sunday Tests. They will get full credit for such tests. They have to appear in balance number of tests, if any, as per the New Eligibility Test Paper Scheme.

Students those who have already complied with the requirements of the New Eligibility Test Paper Scheme by appearing in the required number of Sunday tests or more will be issued Eligibility Certificate once they pass such tests. Similarly, students who have already submitted the required number of Postal Test Papers or more will be issued the Eligibility Certificate once they pass such test papers.

### 2. Endowment Scholarships (w.e.f. 1st October, 2005)

Name of scholarship	Sponsors	Number	Amount (Rs) P.M
R K Khanna Memorial Scholarships	U C Khanna Memorial Charitable Society, New Delhi	3	300

#### **Note**

- (i) The income of parents/guardians should not exceed Rs.1,00,000 pa.  
(ii) Applicants for the grant of scholarships should be registered students. The scholarship will be paid to the students of PE-II Course for 18 months and to students of Final Course for 30 months / balance period of articleship.
- Scholarship is liable to be discontinued if the recipient does not clear Both Groups of PE-II and Final Course conducted by the Institute in the first two available chances. (Non-appearance at the Examination will be considered as non-clearance of the Examination).
- The scholarships will be released in with effect from 1st October, 2005. The duly completed application should be submitted in the prescribed form marked distinctly on the top the name of the Scholarship applied for and it should reach to Director of Studies, The Institute of Chartered Accountants of India, ICAI Bhawan, Post Box No. 36, C-1, Sector-1, NOIDA-201 301, latest by 25th November, 2005. The application forms can be had from the Institute's offices at New Delhi, NOIDA and Regional Offices by sending a request along with a self-addressed envelope affixed with a postal stamp of Rs.5. Alternatively application form can be downloaded from web site of the Institute.

## ANNOUNCEMENTS

### 3. 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 articled clerks.

Articled Clerks who wish to avail themselves of the scholarship for the year 2005-06 should submit their applications in the prescribed form, given below, latest by December 31, 2005.

#### FORM OF APPLICATION

The Secretary,  
Managing Committee of S.Vaidyanath Aiyar Memorial Fund  
C/O The Institute of Chartered Accountants of India  
P.O.Box No. 7100, I.P.Marg, New Delhi - 110 002

Dear Sir,

In pursuance of the announcement made by the Committee for the award of scholarship for the year 2005-2006. I hereby apply for a scholarship to be granted to me for a period of one year. I have studied the conditions on which the scholarship are to be awarded and I am eligible thereunder. I undertake to abide by all terms and conditions laid down by the Committee and give below necessary particulars regarding myself.

1. Article Registration No \_\_\_\_\_
2. Name in Full \_\_\_\_\_  
(Capital letters)
3. Place and Date of Birth \_\_\_\_\_
4. Nationality and the State to which belongs \_\_\_\_\_
5. Full address:
  - a. Present \_\_\_\_\_
  - \_\_\_\_\_
  - b. Permanent \_\_\_\_\_
  - \_\_\_\_\_
6. Married or Single \_\_\_\_\_
7. (a) Father's Name (in Full) \_\_\_\_\_  
(b) Nationality and State \_\_\_\_\_  
(c) Occupation \_\_\_\_\_  
(d) Address:
  - i. Present \_\_\_\_\_
  - \_\_\_\_\_
  - ii. Permanent \_\_\_\_\_
  - \_\_\_\_\_
8. (a) Guardian's name\*\* (in full) \_\_\_\_\_  
(b) Occupation \_\_\_\_\_  
(c) Address:
  - i. Present \_\_\_\_\_
  - \_\_\_\_\_
  - ii. Permanent \_\_\_\_\_
  - \_\_\_\_\_
9. Total monthly income from all \_\_\_\_\_  
sources of parents/guardians  
(Documentary evidence should be sent)

10. Particulars of School/College /University etc. where the applicant had studied (Any break in the education career should be indicated in the remarks column and attested copies of the certificates should be sent with this form)

Name of School/ College/ University	Date of entering & leaving	Subjects studied	Examination passed	Division awarded & % of marks	Remarks

11. Name and address of the employer under whom practical training is being received \_\_\_\_\_

#### 12. S.No. Particulars of any Testimonial or Certificate(s) attached

1.	
2.	
3.	
4.	
5.	

Place: \_\_\_\_\_ Signature \_\_\_\_\_  
Date: \_\_\_\_\_ (Article Registration No. \_\_\_\_\_)

\*\* Strike out if father is the guardian:

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

### 4. Students' Exchange Programme-2006

The SAFA (South Asian Federation of Accountants) Committee on Education, Examination, Training and CPE has proposed to organise, inter-alia, a Students Exchange Programme with the Institute of Chartered Accountants of Nepal. Under the exchange programme, 10 students of ICAI would be visiting Nepal sometime in January / February, 2006. These students will be exposed to the Professional Environment, Education & Training System apart from the local national environment of the host country.

It is proposed to select the students for the exchange programme based on the following criteria:

- ◆ Students who have not passed the final examination of the Institute and are undergoing the articled training or have completed the articled training but period of 12 months have not elapsed since completion of practical training.
- ◆ Preference to be given to rank holders, participants of elocution, quiz contests, students presenting papers - Regional/State Level/ All India Seminars/Conferences.
- ◆ Fluency in English (spoken and written).
- ◆ Maximum age 21 years.
- ◆ Proficiency in Computer literacy, inclusive of MS Office / Accounting package / Power Point Presentation.
- ◆ Successful Participation in a half - day orientation training programme in communication and presentation skills. This programme will be organised by ICAI for the selected students of the programme to give them orientation about the Institute's

activities since they shall act as brand ambassadors of the Institute. If required, short-listed candidates may be called for an interview and the decision of the Interview Committee will be final.

Each selected student will be required to send to ICAI Rs. 7,500 by way of demand draft toward participation fee for meeting expenses on account of travel, etc immediately on receipt of intimation of the selection. Participating students will be required to submit photocopy of their Voter Identity Card / Passport along with the fee for participation. They will be required to report to the New Delhi / Noida Office of the Institute on the specified date and time at their own cost and to carry with them during the trip their Voter Identity Card / Passport.

Students fulfilling the above requirements and wishing to avail of this opportunity may send their particulars (specifically mentioning contact telephone / mobile number and e-mail address) in the form of an application and send the same by Speed Post/ Courier, so as to reach **Dr. S.K. Chatterjee, Additional Director (SG), The Institute of Chartered Accountants of India, C-1, Sector-1, Noida-201 301 by December 9, 2005.**

Similar programme with the Institute of Chartered Accountants of Pakistan is also being considered. Separate announcement in this regard for selection of students will be made in due course once the programme is finalised. Interested students are advised to refer to 'the Chartered Accountant student' - the Students' Newsletter / Website of the Institute.

#### 5. Hindi version of study material and Suggested Answers

The Board of Studies is glad to announce that Hindi version of Suggested Answers for May, 2004, November, 2004 and May, 2005 Final Examination priced at Rs.40/- each per Group are available for sale at the Sales Counters of Regional Offices. These will be made available at sales counters of Branches of Regional Offices as per the requirement of the students.

Students may also note that study material in Hindi for Professional Education (Course - I), Professional Education (Course - II) and Final Course is already available for sale as well as is being supplied to the students opting for receipt of study material in Hindi at the time of registration for the respective course. Students can also purchase directly from the publishers of these study materials:

#### For PE-I, PE-II study materials and Suggested Answers

M/s Shree Mahavir Book Depot (Printing Division)  
2621, Nai Sarak, (Amir Chand Marg), Delhi - 110 006

#### For Final study material and Suggested Answers

M/s. Bharat Law House Pvt. Ltd.  
T-1/95, Mangolpuri Industrial Area, Phase-I,  
New Delhi - 110 083

#### 6. Corrigendum

#### November, 2005 Examination - Applicability of Auditing and Assurance Standards (AASs) to PE-II Candidates

Attention of candidates is invited to announcement for November, 2005 examination published in October, 2005 issue of 'The Chartered Accountant Student'. In respect of Professional Education (Examination-II) candidates, it is clarified that PE-II candidates are expected to have familiarity with **AAS 1 to AAS 28** instead of AAS 11 to AAS 28 as stated inadvertently on Page 25 of the Students' Newsletter. The error is regretted.

## Students' Corner

### DO IT IF YOU LOVE IT

**Vaibhav Nahar**

Five ways of achieving personal and professional excellence

**Do what you love:** You can't achieve excellence in any field unless you have a passion for it, which emanates from your natural aptitude and love for it. Don't enter a profession however promising, if you don't like it.

**Love what you do:** Unless completely immersed in the work, you can not create outstanding results. Total commitment is a small price to pay for what you want to achieve.

**Develop required skills and habits:** Do an honest self audit and beside acquiring the required knowledge develop the skills and habits which are necessary to succeed in your chosen work.

**Set realistic goal:** While too soft goals lead to under-utilisation of your potential, infeasible goals leads to demoralization. Assess capabilities objectively and set goals which are challenging yet achievable.

**Develop a Positive "can do" attitude:** "You can, if you think you can" firmly believe in yourself and your goals. Choose relevant role models. They are the best teacher and provide you the inspiration and motivation to achieve your goals.

### Knowledge! - The Greatest Power on the Earth

**Vaibhav Nahar**

Do you know what power means? It is the one that enables us to perform anything. Power can be various kinds such as Physical, Mental, Economic, Social, Moral or Spiritual etc. But knowledge is the greatest power on the earth as it enables a man to do anything, yes, almost every thing. By using this power, man has become the master of the world and has achieved those goals that were considered unattainable in the past. Today man is able to reach the moon and other planets; he can travel faster than the speed of sound; can replace any organ of the body and can send and receive messages in almost no time. In short, man has reached the Zenith of Progress; but alas, he has turned towards materialistic ways than to be spiritual. Man is using this power just for worldly achievements. While he ought to use it for spiritual end. True knowledge brings us nearer to God but we are today moving away from our eternal aim or end. It tells us what we are and what is the real aim of our life.

True knowledge is the knowledge about oneself. When we come to know what we are, it will be our greatest achievement.

'O' Almighty Lord, give me the power to know myself and to know thee.

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### Tension to Hypertension

**Jagrut Vilas Muley**

The moment you are in *tension*  
You will lose your *attention*  
Then you are in total *confusion*  
And you feel *irritation*  
Then you'll spoil personal *relation*  
Ultimately you won't get *cooperation*  
Then you'll create *complication*  
Then your BP may also rise *caution*  
And you may have to take *medication*  
Instead, understand the *situation*  
And try to think about *solution*

Many problems are solved by *discussion*  
This may work out better in your *profession*  
Don't think it's my *suggestion*  
It is only for your *prevention*  
If you understand my *intention*  
You will never suffer from *hypertension*

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### What is this CA all about?

**Ankur B. Nishar**

What is this CA all about?  
A common man usually cannot even make out.  
Some call it 'Complete Aaram', some call it 'Come Again'.  
It is rightly the "Chartered Accountant" the fact remains.  
Three years of study and three years of Articleship,  
sun it up together and enjoy a fun-filled trip.  
The story so far is nothing but formal,  
Not ever reached half way, it has to be normal.  
Started with PE (Course-I) with subjects simple and fair;  
Study was less and Test Paper was more.  
Here came our exams and wide open were our books  
Slowly and steadily changed our expression and books  
Luckily for us, the papers were simple,  
And padded up were we for the next stage, the semi-final  
Finally in PE (Course-II) with subjects simple and six,  
Modules became thicker and life was in a fix.  
Life was never so "wonderful" and "easy",  
As all of us appear charged up and busy.  
Busy of course in classes, computers and c.c.,  
Not to be mistaken by serious study.  
The facts end here and runs wild my imagination,  
As mind game we play tackling different situations.  
I sometimes wonder about the hype created,  
By just looking at Final results, one feels saturated.  
Its tough, its difficult, it is almost impossible,  
Not an adjective is left to describe the struggle.  
May and November are what students look at,  
With sleepless nights determined to give a fight.  
By chance you are unprepared, you will be gifted an attempt  
Double will be the hours next time you will spend.  
Thus, a lot we have heard about this degree and course,  
'Crocin' may be the solution but not a recourse.



## ANNOUNCEMENTS

### New publications of Board of Studies

For the benefit of students following new publications are released or in the course of being released. Students are advised to acquire a copy of the same at the earliest.

Publication	Price (Rs)	Status
<b>1. Compilation of questions set in previous examinations with answers</b>		
<b>Professional Education (Course - I)</b>		
<i>Paper 1: Fundamentals of Accounting</i>	40	Available
<i>Paper 2: Mathematics and Statistics</i>	40	Available from November 14
<i>Paper 3: Economics</i>	40	Available
<i>Paper 4A: Business Communication</i>	25	Available
<i>Paper 4B: Organisation and Management</i>	25	Available
<b>Professional Education (Course - II)</b>		
<i>Paper 1: Accounting</i>		Available
<i>Paper 3: Business and Corporate Laws</i>	40	Available
<i>Paper 4 A: Cost Accounting</i>	40	Available from November 21
<i>Paper 4 B: Financial Management</i>	40	Available
<i>Paper 6: Information Technology</i>	40	Available
<b>Final</b>		
<i>Paper 1: Advanced Accounting</i>	60	Available
<i>Paper 2: Management Accounting and Financial Analysis</i>	60	Available
<i>Paper 4: Corporate Laws and Secretarial Practice</i>	60	Available
<i>Paper 5: Cost Management</i>	60	Available from November 21
<i>Paper 6: Management Information and Control System</i>	60	Available
<b>2. Compilation of questions set in previous examinations</b>		
Professional Education (Course - I)	30	Available
Professional Education (Course - II)	30	Available
Final	30	Available
<b>3. Supplementary Study Paper - 2005</b>		
Professional Education (Course - II) : <i>Income-tax and Central Sales-tax</i>	30	Available
Final : <i>Direct Taxes and Indirect Taxes</i>	40	Available
<b>4. Suggested Answers to Questions set in May, 2005 Examination</b>		
Professional Education (Course - I)	40	Available
Professional Education (Course - II) : <i>Group I &amp; II</i>	40 each	Available
Final Course : <i>Group I &amp; II</i>	40 each	Available
<b>5. Self-development Booklet 6 : Audit Documentation</b>		
	25	Available

**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 : Jaydeep Narendra Shah**

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